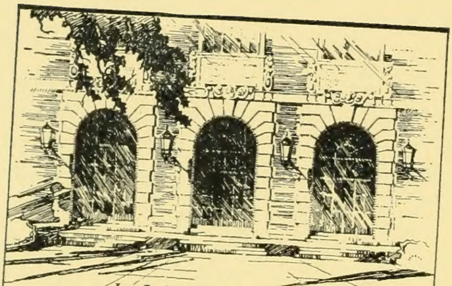
Report of the Commission on Revenue

STATE OF ILLINOIS

1963



REPORT OF THE COMMISSION ON REVENUE

Report of the Commission on Revenue

OF THE

STATE OF ILLINOIS

Springfield, Illinois

1963

PRINTED BY FRYE PRINTING COMPANY

THE COMMISSION ON REVENUE

MEMBERS OF THE COMMISSION

Senators

W. Russell Arrington
Phillip J. Carey
Edward C. Eberspacher
Seymour Fox
William C. Harris
Everett E. Laughlin

Representatives

Terrel E. Clarke
Lee E. Daniels
Paul F. Elward
James P. Loukas
John K. Morris
John C. Parkhurst
Walter J. Reum*

*(Resigned and replaced by Representative Terrel E. Clarke)

MEMBERS APPOINTED BY THE GOVERNOR

Crowdus Baker*
Charles F. Conlon
Robert S. Cushman

*(Resigned and replaced by Raymond T. Kilbride)

Raymond T. Kilbride
Verle E. Kramer
Dr. Norton E. Long
Paul E. Mathias

OFFICERS OF THE COMMISSION

Chairman .... Robert S. Cushman
Vice Chairman .... Representative John K. Morris
Secretary .... Senator W. Russell Arrington

RESEARCH STAFF

H. Kenneth Allen .... *Director of Research*
Vernon G. Morrison .... *Assistant Director of Research*

Research Associates*

Jacob O. Bach
Ruth A. Birdzell
Robert N. Corley
Robert Ferber
Glenn W. Fisher
Neil Ford
Edward Griffin
Ralph O. Gallington
William Habacivch
Robert W. Harbeson
A. James Heins
William H. Heneberry
Irving Howards
Eugene S. Lawler
Karl B. Marx
William P. McLure
Robert I. Mehr
Ronald Racster
Robert G. F. Spitze
Case M. Sprenkle
Richard K. Vedder
Dale H. Weeks
J. Nelson Young

*The research associates worked part time for the Commission on a special assignment basis. Their reports, with identification of the authors, are included in the research staff report which appears later as Part Two of the Commission's report.

ACT ESTABLISHING THE COMMISSION

House Bill No. 17

Seventy-second General Assembly, First Special Session, 1961

An act to create a Commission to study and to make recommendations relating to the means and methods of revising and improving the revenue structure of Illinois and to make an appropriation in connection therewith.

Be it enacted by the People of the State of Illinois, represented in the General Assembly:

Section 1. There is created a Commission on Revenue, hereafter referred to as the Commission, which shall consist of 6 members of the House of Representatives to be appointed by the Speaker thereof, 6 members of the Senate to be appointed by the Committee on Committees thereof and 6 persons to be appointed by the Governor. Of the members selected by each appointing authority no more than 3 shall be affiliated with the same political party.

The members of the Commission shall organize, select a chairman from their own number and provide such rules as are deemed necessary for the transaction of business. The members shall serve without compensation but shall be reimbursed for necessary expenses. Vacancies shall be filled in the same manner as original appointments.

Such Commission's powers and duties shall terminate on July 1, 1963.

Section 2. The Commission shall study, analyze and review the present and future fiscal requirements of the State and its political subdivisions; analyze all existing and potential sources of revenue to the State and its political subdivisions; investigate and make recommendations where economies in state government may be achieved and prepare a financial chart for the future based upon realistic estimates of the State's needs in the years ahead; make recommendations with respect to improvement of revenue measures and the revenue structure; and shall study and make recommendations with respect to all other matters related to the revenue structure of the State and its political subdivisions.

The Commission is authorized to call before it all officers and employees of the State or other governmental units who may be of assistance in advising the Commission and also is authorized to call before it any member of the public who through practical and expert knowledge of revenue matters might be of aid in the Commission's study.

Section 3. The Commission may conduct hearings, administer oaths, examine witnesses and issue subpoenas for the attendance and testimony of witnesses and the production of books, records and documents neces-

sary to the performance of its duties. Any circuit court of this state, or any judge thereof, in term time or vacation, upon application of the Commission, may, in his discretion, compel the attendance of witnesses, the production of books, records and documents, and the giving of testimony before the Commission, by an attachment for contempt or otherwise in the same manner as production of evidence may be compelled before said court.

Section 4. The Commission is authorized to employ and fix the compensation of such employees and assistants as are deemed necessary without reference to any law relating to civil service or job classification. based on merit principles.

Section 5. The Commission shall report its findings and recommendations to the Governor and the General Assembly no later than March 15, 1962. If the General Assembly is not in session at that time such report shall be made to the President Pro Tempore of the Senate, the Speaker of the House of Representatives, the chairmen of the Revenue Committee and Executive Committee of each House and the chairman of the Budgetary Commission in lieu of to the General Assembly.

Section 6. In addition to the amount appropriated by Section 3 of Senate Bill No. 613 of the regular session of the Seventy-second General Assembly, approved August 1, 1961, for the expenses of a commission such as is created by this Act, the sum of $50,000, or so much thereof as may be necessary, is appropriated to the Commission created by this Act for the purpose of carrying out its duties under this Act.

Section 7. Whereas, it is imperative to the fiscal health of State and local governments that the Commission immediately commence functioning and conclude its duties with all reasonable dispatch, therefore an emergency exists, and this Act shall take effect upon its becoming a law.

APPROVED NOVEMBER 30TH, 1961

LETTER OF TRANSMITTAL

June 15, 1963

To the Honorable Otto Kerner
Governor of the State of Illinois
and Members of the Seventy-Third
General Assembly:

On March 15, 1962, the Commission on Revenue created pursuant to H.B. 17 of the First Special Session of the Seventy-Second Session of the Illinois General Assembly filed an interim report of its progress to that date. The Commission has now completed Parts I and II of its Report containing both projections and estimates of revenues and expenditures and recommendations and the various detailed studies by the research staff.

The Commission hopes that its report will contribute in some small way to the solution of the pressing financial problems of the State of Illinois.

Respectfully submitted,

Robert S. Cushman, *Chairman*
Representative John K. Morris, *Vice Chairman*
Senator W. Russell Arrington, *Secretary*

ACKNOWLEDGMENTS

The Commission wishes to acknowledge the invaluable assistance which it received from the University of Illinois, Northern Illinois University, Southern Illinois University, and Western Illinois University in making available to the Commission on a no-cost or nominal cost basis the services of the professors and research assistants who composed the research staff. Without this generous assistance the Commission could not have accomplished any useful results.

The Commission also acknowledges the help and assistance of numerous State officials and agencies who cooperated in furnishing the data requested by the Commission. Among these are the Department of Revenue, Department of Finance, Legislative Council, State Treasurer, Attorney General, Secretary of State, Department of Insurance, Superintendent of Public Instruction, Department of Financial Institutions, Department of Mental Health, Illinois Public Aid Commission, School Problems Commission, Department of Public Works and Buildings (Highways), Department of Registration and Education, Board of Higher Education and Board of Vocational Guidance.

Business, agricultural and taxpayer organizations cooperated in furnishing the Commission useful data. Among these were the Illinois State Chamber of Commerce, the Illinois Agricultural Association, Taxpayers' Federation of Illinois, The Civic Federation, Illinois Manufacturers Association, and Chicago Association of Commerce and Industry. The Commission is greatly indebted to Miss Dawn Clark, Governor Kerner's Administrative Assistant, and to Miss Edith Graham for the excellent secretarial and other services rendered the Commission.

Table of Contents

PART ONE

PART TWO

Table of Contents (Continued)

Report of the Commission on Revenue

PART ONE

Projections and Estimates of Revenue

and

Expenditures and Recommendations

CHAPTER I

ORGANIZATION AND PROCEDURE

Legislative Authority

The Revenue Study Commission was authorized by House Bill No. 17 of the First Special Session of the Seventy-Second General Assembly which was approved by Governor Kerner on November 30, 1961. The text of the law is set out in full at page 1 of this report.

Organization of the Commission

In accordance with the provisions of House Bill No. 17, eighteen persons were appointed to serve as members of the Commission.

The following six senators were appointed by the Committee on Committees of the Senate to serve as members of the Commission:

W. Russell Arrington (Lawyer)
Phillip J. Carey (Lawyer)
Edward C. Eberspacher (Lawyer)
Seymour Fox (Lawyer)
William C. Harris (Insurance)
Everett Laughlin (Lawyer)

The following six representatives were appointed by the Speaker of the House:

Terrel E. Clarke (Insurance)
Lee E. Daniels (Lawyer)
Paul F. Elward (Lawyer)
James P. Loukas (Accountant)
John K. Morris (Farmer)
John C. Parkhurst (Lawyer)
Walter J. Reum* (Lawyer)
*(Resigned and replaced by Representative Terrel F. Clarke)

The following six citizens were appointed by Governor Kerner:
Crowdus Baker*
Robert S. Cushman, Lawyer
Charles F. Conlon, Executive Director, Federation of Tax Administrators
Verle Kramer, Editor
Dr. Norton E. Long, Staff Consultant, Governor's Office
Paul E. Mathias, Attorney for Illinois Agricultural Association

At the organizational meeting of the Commission the following officers were elected:

Chairman .... Robert S. Cushman
Vice Chairman .... Representative John K. Morris
Secretary .... Senator W. Russell Arrington

*(Resigned and replaced by Raymond T. Kilbride, Tax Manager, Montgomery Ward & Co.)

The Commission created the following subcommittees:

Name of Committee	*Assignment*
1. A Ten-Year Projection of the Economic Base of the State of Illinois	Charles F. Conlon, *Chairman* Phillip J. Carey Norton E. Long Raymond T. Kilbride
2. Relief	Verle Kramer, *Chairman* John C. Parkhurst John K. Morris W. Russell Arrington
3. Penal Institutions, Mental Institutions, Health Service and other Welfare Services	W. Russell Arrington, *Co-Chairmen* Norton E. Long John K. Morris
4. Education	Edward C. Eberspacher, *Chairman* Paul F. Elward John C. Parkhurst Verle Kramer
5. Highways	William C. Harris, *Chairman* Paul E. Mathias John C. Parkhurst Seymour Fox
6. Committee on Economy Measures	John C. Parkhurst, *Chairman* Everett E. Laughlin Norton E. Long Verle Kramer W. Russell Arrington
7. Ultimate Incidence of Particular Taxes	John K. Morris, *Chairman* Lee E. Daniels John C. Parkhurst Seymour Fox
8. Tax Administration	James P. Loukas, *Chairman* Charles F. Conlon Paul F. Elward
9. Earmarked Funds	Paul F. Elward, *Chairman* James P. Loukas Lee E. Daniels

Name of Committee	*Assignment*
10. Revenue Resources and Powers of Local Government	Seymour Fox, *Chairman*
	Terrel E. Clarke
	Raymond T. Kilbride
11. Tax Burden in Illinois Compared to Other States	Raymond T. Kilbride, *Chairman*
	William C. Harris
	John C. Parkhurst
	Everett E. Laughlin
	Norton E. Long
12. Study of Constitutional Limitations and Possible Recommendations for Modernizing the Constitution	Paul E. Mathias, *Chairman*
	Edward C. Eberspacher
	William C. Harris
	Seymour Fox
	Phillip Carey
	Everett E. Laughlin
	W. Russell Arrington
	Charles F. Conlon
	Terrel E. Clarke
	John K. Morris
	Paul F. Elward

Research Staff

Dr. H. Kenneth Allen, Professor of Economics at the University of Illinois, who was also Director of Research of the 1949 Revenue Laws Commission, was engaged as the Commission's Director of Research. Dr. Vernon G. Morrison, Assistant Dean, School of Business at Southern Illinois University, who also was a member of the technical staff of the 1949 Revenue Laws Commission, was engaged as the Commission's Assistant Director of Research. Upon the recommendation of the Director and the Assistant Director the members of the technical staff listed on page ii of the report were engaged. All have had prior contacts with State and local tax and fiscal problems and were selected for their special competence in this field. Their research reports will be published in full in Part Two of the Commission's report.

Procedure followed by the Commission

Each member of the technical staff presented his research report to the Commission for comment and criticism. If the Commission desired additional data, it was supplied if obtainable.

The subcommittee on Economy Measures and on Constitutional Revision held numerous hearings, both in Chicago and in Springfield, at which all interested persons were invited to attend. Many organizations responded

to the invitation and made numerous suggestions for economy and for constitutional revision. A questionnaire was submitted by the subcommittee on Economy Measures to all state officers and agencies and suggestions for economy were invited. The responses were used by the subcommittee in its deliberations. The subcommittee on Economy Measures, the subcommittee on Constitutional Revision and the subcommittee on Earmarking prepared and filed reports with the Commission to which reference will be made later in this report.

After all the research reports were presented and subcommittee reports were filed, a committee composed of the officers of the Commission digested the reports and prepared a summary of the recommendations which the research and subcommittee reports contained. The Commission then tentatively approved or rejected these recommendations. These tentative recommendations were then distributed to the members of the Commission who took final action on them at a meeting held on February 18, 1963 in Springfield.

A drafting committee composed of the officers of the Commission and Messrs. Long, Conlon and Mathias were appointed to prepare and did prepare this report which was distributed to all members of the Commission for suggestions before publication.

Form of the Report

The Commission's report, like the report of the 1949 Revenue Laws Commission, is presented in two parts. Part One contains the projections of expenditures and revenue, together with recommended changes in tax laws with a brief statement of the reasons for each recommendation. Part One also contains a list of new taxes and charges which the Commission has studied. In some instances the levy of new taxes is recommended. In other instances the Commission merely makes a statement of the arguments for and against the new tax and the estimated amount of new revenue which the tax will produce.

Part Two of the report consists of the reports of the technical staff upon which the projection and recommendations contained in Part I are based.

CHAPTER II

ESTIMATES AND PROJECTIONS OF EXPENDITURES OF STATE GOVERNMENT THROUGH THE YEAR 1971 AND RELATED DATA

1. The Projected Economic Growth of Illinois to 1971

"The projected economic growth of Illinois to 1971" is a research paper prepared by Robert Ferber and Neil Ford. In the report the authors show that economic trends in Illinois almost exactly mirror the economic trends in the United States as a whole and that valid projections for Illinois can be made from similar projections for the United States. Since the paper is printed in full in Part Two of this report, only a few of the most important projections will be included here.

Table 4 of the report gives the actual and projected income and population of Illinois for the years 1950-1971 as follows:

TABLE 4
Estimated and Projected Income and Population of Illinois, 1950-1971

(1) Year		(2) Per capita income 1961 prices (dollars)			(3) Population (thousands)			(4) Personal income 1961 prices (billions of dollars)	
1950		2,290			8,712			20.0	
1951		2,394			8,752			20.9	
1952		2,414			8,840			21.3	
1953		2,514			2,988			22.6	
1954		2,456			9,134			22.4	
1955		2,546			9,237			23.5	
1956		2,675			9,425			25.2	
1957		2,666			9,647			25.7	
1958		2,558			9,949			25.4	
1959		2,656			9,974			26.5	
1960		2,663			10,081			26.8	
1961		2,676			10,260			27.4	
	High	Medium	Low	Series I	Series II	Series III	High	Medium	Low
1962	2,775	2,758	2,746	10,687	10,450	10,431	29.0	28.8	28.7
1963	2,845	2,824	2,811	10,887	10,700	10,659	30.4	30.2	30.1
1964	2,925	2,883	2,856	11,058	10,850	10,830	31.7	31.3	31.0
1965	3,016	2,952	2,909	11,343	10,977	11,035	33.1	32.4	31.9
1966	3,118	3,030	2,972	11,571	11,300	11,172	35.2	34.2	33.6
1967	3,193	3,080	3,007	11,799	11,500	11,286	36.7	35.4	34.5
1968	3,279	3,140	3,051	12,027	11,750	11,514	38.5	36.9	35.8
1969	3,377	3,211	3,104	12,255	11,900	11,685	40.2	38.2	36.9
1970	3,478	3,283	3,159	12,512	12,047	11,867	41.9	39.5	33.1
1971	3,583	3,359	3,216	12,768	12,400	12,084	44.4	41.6	39.9

Sources: 1950-1961 data from *1961 Statistical Abstract of the United States and Survey of Current Business*, Aug., 1962, Series II (medium) population projections from *Financing Education in the 1960's*, Special Project on School Finance, Research Division, National Education Association. Series I (high) and III (low) were derived by obtaining Illinois' share of population times Series I and III figures on Table 2. Per capita income was obtained by multiplying projected U.S. per capita income by Illinois' projected share of per capita income, e.g., in 1962 Illinois per capita income will be 118.03% of U.S. per capita income.

Table 5 of the report gives the estimated and projected distribution of Illinois population by age groups for the years 1950-1971 as follows:

TABLE 5

Estimated and Projected Population of Illinois by Age, 1950-1971
(Medium Projection)
(Thousands)

Year	Total	Under 5	5-13	14-17	18-21	22-64	65 and over	14 and over	Percent 65 and over	Percent 14 and over
1950	8,712	843	1,141	424	366	5,184	754	6,728	8.7	77.2
1951	8,752	906	1,154	454	326	5,131	781	6,692	8.9	76.5
1952	8,840	905	1,215	459	300	5,157	804	6,720	9.1	76.0
1953	8,988	926	1,280	553	234	5,164	831	6,782	9.2	75.5
1954	9,134	947	1,411	475	287	5,160	854	6,776	9.3	74.2
1955	9,237	970	1,464	471	294	5,176	862	6,803	9.3	73.6
1956	9,425	1,001	1,541	490	300	5,212	882	6,884	9.4	73.0
1957	9,647	1,039	1,602	532	310	5,260	904	7,006	9.4	72.6
1958	9,949	1,070	1,679	567	342	5,376	914	7,199	9.3	73.0
1959	9,974	1,107	1,662	571	405	5,274	955	7,205	9.6	72.2
1960	10,081	1,130	1,732	576	482	5,185	976	7,219	9.7	71.6
1961	10,260	1,150	1,780	610	510	5,220	990	7,330	9.6	71.4
1962	10,450	1,175	1,810	642	539	5,250	1,005	7,465	9.6	71.4
1963	10,700	1,210	1,845	680	568	5,290	1,020	7,645	9.5	71.4
1964	10,850	1,245	1,880	720	595	5,310	1,040	7,725	9.6	71.4
1965	10,977	1,252	1,936	758	628	5,339	1,064	7,789	9.7	71.0
1966	11,300	1,320	1,960	780	655	5,410	1,075	8,020	9.5	71.0
1967	11,500	1,350	2,000	800	680	5,480	1,095	8,150	9.5	70.9
1968	11,750	1,395	2,050	823	710	5,520	1,120	8,305	9.5	70.7
1969	11,900	1,440	2,090	845	739	5,600	1,140	8,370	9.6	70.3
1970	12,047	1,480	2,127	859	763	5,653	1,166	8,440	9.7	70.1
1971	12,400	1,510	2,180	888	798	5,720	1,175	8,710	9.5	70.2

Source: 1950-1961 data from *Current Population Reports*, Series P-25, Bureau of the Census 1962-1971 projections from *Financing Education in the 1960's*, Special Project on School Finance, Research Division, National Education Association.

Estimated and projected Illinois population by area, medium projection, for the years 1950-1971 is shown in Table 7 as follows:

TABLE 7

Estimated and Projected Illinois Population by Area, 1950-1971, Medium Projection (Thousands)

Year	State total	Metropolitan Areas									Non-metropolitan
		Total	Chicago	Champaign	Decatur	East St. Louis	Peoria	Rock-ford	Rock Island	Spring-field	
1950	8,712	6,439	5,178	106	99	388	251	152	134	131	2,273
1951	8,752	6,577	5,287	109	101	399	255	158	135	133	2,230
1952	8,840	6,610	5,295	111	103	407	258	164	137	135	2,232
1953	8,988	6,700	5,360	114	105	416	262	169	138	136	2,256
1954	9,134	6,805	5,441	116	106	425	265	174	140	138	2,284
1955	9,237	7,009	5,620	118	108	434	269	180	141	139	2,240
1956	9,425	7,152	5,735	121	110	444	273	186	143	140	2,238
1957	9,647	7,336	5,894	124	112	453	276	191	144	142	2,285
1958	9,949	7,521	6,051	126	114	463	280	198	146	143	2,395
1959	9,974	7,618	6,120	129	116	473	284	204	147	145	2,325
1960	10,081	7,743	6,217	132	118	483	288	210	149	146	2,333
1961	10,260	7,918	6,363	135	120	493	293	216	151	147	2,336
1962	10,450	8,097	6,504	139	123	503	298	222	156	152	2,341
1963	10,700	8,337	6,710	143	126	513	305	228	158	154	2,357
1964	10,850	8,498	6,841	147	128	523	308	234	161	156	2,350
1965	10,977	8,651	6,963	151	131	533	312	240	163	158	2.337
1966	11,300	8,929	7,204	155	134	543	320	246	165	162	2.364
1967	11,500	9,112	7,354	159	137	553	325	252	168	164	2,363
1968	11,750	9,329	7,532	163	140	563	333	258	172	168	2,371
1969	11,900	9,537	7,710	167	143	573	336	264	174	170	2,357
1970	12,047	9,745	7,888	171	145	583	340	270	176	172	2 342
1971	12,400	9.974	8,075	175	149	593	350	276	180	176	2,370

Source: 1950-1961 data from *Health Statistics Bulletin*, State of Illinois, Spl. Release No. 46, Oct., 1960.

The estimated and projected Illinois personal income by area, 1950 to 1971, in terms of 1961 dollars is shown on Table 9 as follows:

TABLE 9

Estimated and Projected Illinois Personal Income by Area, 1950-1971, Medium Projection in Millions of 1961 Dollars

Year	State total	Metropolitan Areas									Non-metropolitan
		Total	Chicago	Champaign	Decatur	East St. Louis	Peoria	Rock-ford	Rock Island	Spring-field	
1950	20,000	16,335	13,779	232	190	728	523	337	299	247	3,516
1951	20,900	17,466	14,730	249	204	781	555	369	316	262	3,599
1952	21,300	17,776	14,958	255	211	803	567	389	324	269	3,582
1953	22,600	18,777	15,785	269	228	852	599	421	341	282	3,716
1954	22,400	18,662	15,688	266	224	847	592	426	339	280	3,700
1955	23,500	19,832	16,691	279	243	884	621	470	343	301	3,734
1956	25,200	21,135	17,750	300	267	955	662	521	353	327	3,979
1957	25,700	21,548	18,136	308	268	954	662	516	369	335	4,177
1958	25,400	21,096	17,820	306	260	930	640	498	370	326	4,230
1959	26.500	22,289	18,758	315	268	1,005	698	528	384	333	4,150
1960	26,800	22,629	19,005	326	274	1,030	714	551	390	339	4,188
1961	27,400	23,141	19,407	334	281	1,077	727	572	398	345	4,254
1962	28,800	24,367	20,436	354	298	1,109	764	612	424	370	4,366
1963	30,200	25,693	21,579	372	313	1,155	802	645	440	387	4,492
1964	31,300	26.683	22,404	389	325	1,199	827	676	458	405	4,578
1965	32,400	27,719	23,256	409	342	1,247	859	710	475	421	4,667
1966	34,200	29,347	24,666	430	359	1,300	908	747	494	443	4,856
1967	35,400	30.370	25,518	447	375	1,343	940	778	511	458	4,939
1968	36,900	31,664	26,603	466	391	1,392	984	813	534	481	5,055
1969	38.200	32,930	27,672	487	409	1,444	1,016	851	552	499	5,143
1970	39,500	34,346	28,878	509	425	1,499	1,054	890	572	519	5,227
1971	41,600	35,948	30,225	532	448	1,557	1,112	931	598	545	5,418

Professors Ferber and Ford conclude that research report by stating:

"All things considered, the general picture is one of gradual shifts in income and population brought about by the increasing industrialization of the state. Areas which are expected to obtain the greatest industrial development are those which are also expected to prosper the most, both in terms of income and of population. At the same time, certain spill-over effects may be anticipated, with the result that the increases in economic activity should be shared by the bulk of the state's population."

2. Estimated and Projected State Cost of Common Schools

The "Common Schools" is the subject of a research report prepared by Mssrs. Lawler, Bach and Griffin who are, respectively, Professor of Education, Head, Educational Research Bureau and Research Assistant, Educational Research Bureau, Southern Illinois University. Like the other research reports, this will also be published in full in Part Two of this report.

The bulk of State aid to elementary and high schools is in the form of flat grants and equalization aid. The estimated and projected amounts of these aids through the year 1970-1971 is shown in Table 16 of the research report on page 13.

The word "level" in Table 16 means "equalization level." The words "required rate" mean the statutory rate required as a condition to receiving equalization aid. It will be observed that the right-hand column is the total of equalization aid and flat grant aid. These totals are for years and not for biennia.

Table 16 does not include projection for the cost of special aids such as transportation, pensions, handicapped children, etc. The authors estimate that the cost to the State of Illinois for transportation aid will increase from \$9,678,421 for the year 1963-1964 to \$13,271,345 for the year 1969-1970.

TABLE 16

Projection of Amounts of Equalization Aid, Flat Grants and Total Aid Required for Certain Levels of Equalization and Required Local Rates, for School and Legislative years 1962-63 to 1970-71.

School Year	Level	Required El. H.S.	Rate Unit	Equiliza-tion Aid (Millions)	Flat Grant Aid (Millions)	Total Distribu-tive Aid (Millions)	Distributive Aid for Legis-lative Year[1] (Millions)
SERIES I, with valuation increasing at 3½ per cent per year							
1962-63	.....$252	$ .54	$ .67	$101.0	$72.3	$173.3	
1963-64	 324	.72	.89	145.3	75.2	220.5	$197.9
1964-65	 324	.72	.89	146.3	77.2	223.5	222.9
1965-66	 360	.81	1.00	164.0	78.7	242.7	233.1
1966-67	 360	.81	1.00	161.4	80.3	241.7	242.2
1967-68	 400	.90	1.11	176.7	81.7	258.4	250.1
1968-69	 400	.90	1.11	174.6	83.0	257.6	258.0
1969-70	 445	1.01	1.26	190.7	84.1	274.8	266.2
1970-71	 445	1.01	1.26	182.5	85.2	267.7	271.2
SERIES II, with valuation increasing at 3½ per cent per year							
1962-63	.....$252	$ .54	$ .67	$101.0	$72.3	$173.3	
1963-64	 324	.64	.79	176.0	75.2	251.2	$212.2
1964-65	 324	.64	.79	176.3	77.2	253.5	252.3
1965-66	 360	.69	.85	213.4	78.7	292.1	272.8
1966-67	 360	.69	.85	212.2	80.3	292.5	292.4
1967-68	 400	.75	.93	247.3	81.7	329.0	310.3
1968-69	 400	.75	.93	247.5	83.0	330.5	329.7
1969-70	 445	.81	1.00	286.6	84.1	370.7	350.6
1970-71	 445	.81	1.00	280.9	85.2	366.1	379.5
SERIES III, with valuation increasing at 1¾ per cent per year							
1962-63	.....$252	$ .54	$ .67	$101.0	$72.3	$173.3	
1963-64	 324	.72	.89	151.2	75.2	226.4	$199.9
1964-65	 324	.72	.89	156.6	77.2	233.8	230.1
1965-66	 360	.81	1.00	181.8	78.7	260.5	247.2
1966-67	 360	.81	1.00	185.9	80.3	266.2	263.4
1967-68	 400	.90	1.11	218.6	81.7	300.3	283.3
1968-69	 400	.90	1.11	226.7	83.0	309.7	305.0
1969-70	 445	1.01	1.26	249.2	84.1	333.3	321.5
1970-71	 445	1.01	1.26	250.4	85.2	335.6	334.4

[1] The last half of aid for school year 1962-63 and the first half of aid for school year 1963-64 will be paid in the legislative year 1963-64, and so on.

TABLE 18

Projected State Appropriations for Vocational Education Costs Based on Population Trends and Needs

		Day School	Out-of-School	Total (Annual)	Total (Biennium)
1960-61 (Annual)		$ 2,061,500.00	$ 616,225.00	$2,677,725.00	$ 5,355,450.00
1962-63 (Annual)		2,061,500.00	616,225.00	2,677,725.00	
1963-65 (Biennium)	High	8,902,664.00	5,185,664.00		14,088,328.00
	Med.	6,372,874.00	3,865,732.00		10,238,586.00
	Low	3,858,400.00	2,375,700.00		6,234,100.00
1965-67 (Biennium)	High	13,923,428.00	8,948,538.00		22,871,956.00
	Med.	9,760,348.00	6,495,664.00		16,256,012.00
	Low	5,643,000.00	4,064,600.00		9,707,600.00
1967-69 (Biennium)	High	17,506,260.00	10,999,760.00		28,486,020.00
	Med.	12,091,860.00	8,020,700.00		20,112,560.00
	Low	6,725,000.00	4,555,900.00		11,679,900.00
1969-71 (Biennium)	High	20,475,000.00	13,187,400.00		33,662,400.00
	Med.	14,062,000.00	9,479,800.00		23,541,800.00
	Low	7,758,000.00	5,920,200.00		13,678,200.00

Note: In this table, technical education above the high school level is not included. Trends and needs were not well established at the time of this study. Hence, any judgment presented here would be highly invalid. All figures above are estimates with the exception of the 1960-61 annual costs.

3. Estimated and Projected State Cost of Vocational Education

Professor Ralph O. Gallington, Professor of Industrial Education at Southern Illinois University, assisted by Robert Armbrust, graduate accountant, presented a research report to the Commission on the subject "Vocational Education." The authors point out the importance of Vocational Education in reducing the number of drop-outs from elementary and high school and in reducing the number of unskilled job seekers who swell the number of the unemployed and relief recipients. The estimated and projected State cost of Vocational Education through the 1969-1971 biennium is shown in Table 18 of the research report on page 14.

4. Estimated and Projected State Cost of Higher Education

"Higher Education" is the subject of a research paper prepared by Professor William P. McLure assisted by Mr. Dale Kaiser and Mr. Ronald Simcox, research assistants. Like other research papers, his is also printed in Part Two of this report. The author states that his paper relates "to costs of public higher education in the decade from 1960 to 1970." The author includes both State universities and junior colleges in his definition of public institutions of higher learning. He summarizes his projection of costs in three tables. Table 21, which does not include capital expenditures, is as follows:

TABLE 21

Projected State Tax Revenue for Educational and General Expenditures of Higher Education

(in thousands)

Biennium	Low	Medium	High
1961-63*	$221,848	$221,848	$221,848
1963-65	271,578	279,465	287,355
1965-67	330,906	350,331	369,756
1967-69	426,214	465,530	504,848
1969-71	446,053	510,252	574,451

*Actual

Note: These estimates are based on 73 per cent of Total Projected Educational and General Expenditures.

Table 22 sets forth estimates of capital expenditures for public universities only. Nothing is included for expansion of the junior college system. Table 22 is as follows:

TABLE 22

Projected State Tax Revenue for Capital Expenditures of Higher Education (in thousands)

	Payments on Universities Bond Issue	Low		Medium		High	
		Further Expansion of Plants	Total (# 2 Plus # 1)	Further Expansion of Plants	Total (# 4 Plus # 1)	Further Expansion of Plants	Total (# 6 Plus # 1)
Biennium	1	2	3	4	5	6	7
1963-65 ..	$27,635	$49,740	$ 77,375	$59,460	$ 87,095	$ 73,110	$100,745
1965-67 ..	27,635	70,840	98,475	77,860	105,495	84,710	112,345
1967-69 ..	27,635	63,110	90,745	71,235	98,870	74,284	101,919
1969-71 ..	27,635	81,410	109,045	91,760	119,395	106,410	134,045

Table 23 combines tables 21 and 22 and states the total projected costs for public universities and junior colleges (other than the costs of expanding the junior college system) as follows:

TABLE 23

Summary of Projected State Tax Revenue for Educational and General and Capital Expenditures of Higher Education (in thousands)

Biennium	Low	Medium	High
1963-65	$349,953	$366,560	$388,100
1965-67	429,381	455,826	482,101
1967-69	516,959	564,400	606,767
1969-71	555,098	629,647	708,496

5. Estimated and Projected Cost of Public Assistance

The projection of public assistance expenditure in Illinois is the subject of a research paper by Professor Glenn W. Fisher which like the others is published in full in Part Two of this report.

Professor Fisher summarizes his research paper in Table 28 as follows:

TABLE 28

Biennial Expenditure Projections by Source of Funds (Medium Projection)

	1961-63	1963-65	1965-67	1967-69	1969-71
	(Thousand of dollars — 1961 prices)				
Aid to Dependent Children					
Federal Funds	115,675	139,198	164,248	191,413	219,783
State Funds	131,324	158,042	186,481	217,320	249,515
Total Expenditure	246,999	297,240	350,729	408,733	469,298
Old Age Assistance					
Federal Funds	83,215	74,606	66,156	59,058	52,438
State Funds	44,267	42,037	39,726	37,934	35,878
Total Expenditure	127,482	116,643	105,882	96,992	88,316
Disability Assistance					
Federal Funds	26,686	32,102	38,108	44,302	50,928
State Funds	28,983	34,874	41,396	48,121	55,315
Total Expenditure	55,669	66,976	79,504	92,423	106,243
Blind Assistance					
Federal Funds	3,185	2,983	2,862	2,573	2,522
State Funds	3,150	3,132	3,180	3,012	3,104
Total Expenditure	6,335	6,115	6,042	5,585	5,626
General Assistance					
State Funds	140,022	159,986	183,550	207,316	231,303
Local Funds	41,825	47,788	54,826	61,926	69,090
Total Expenditure	181,847	207,774	238,376	269,242	300,393
Administration					
Federal Funds	26.530	31,867	38,140	45,302	53,301
State Funds	26,531	31,867	38,141	45,302	53,302
Total Expenditure	53.061	63,734	76,281	90,604	106,603
All programs					
Federal Funds	255,291	280,756	309,514	342,648	378,972
State Funds	374,277	429,938	492,474	559,005	628,417
Local Funds	41,825	47,738	54,826	61,926	69,090
Total Expenditures	671.393	758,482	856.814	963,579	1,076,479

6. Estimated and Projected Expenditures of the State Departments of Mental Health, Public Health and Public Safety

The following table shows the estimated and projected expenditures for the Departments of Mental Health, Public Health and Public Safety. The estimates and projections were made by Professor Glenn W. Fisher and are the medium projections made by him.

Departments of Mental Health, Public Health, and Public Safety
(millions of dollars)

Biennium	Mental Health (Operations and Grants only)	Public Health (State Funds only)	Public Safety (Excluding Road Fund and Revolving Fund)
1963-65	272.8	19.6	43.4
1965-67	315.8	20.2	38.8
1967-69	328.6	20.7	41.7
1969-71	351.6	21.3	40.5

7. Estimated and Projected State Highway Expenditures

The estimates of State highway expenditures were made for the Commission by Ronald L. Racster, assistant in finance at the University of Illinois. He based his estimates on the assumption that State highway expenditures would equal the moneys available for that purpose from the Motor Fuel tax, registration fees and federal grants. These estimates are summarized in Table 27 of his research paper as follows:

TABLE 27
Total Projected Revenues, Available for Highway Purposes, by Biennium, 1961-1963 Through 1969-1971[1]
(in millions of dollars)

Biennium	High	Medium	Low
1961-1963	879.5	876.1	874.4
1963-1965	979.9	970.7	964.0
1965-1967	1,074.7	1,052.7	1,039.0
1967-1969	1,166.1	1,130.3	1,106.7
1969-1971	1,239.8	1,186.9	1,154.9

SOURCE: Tables XI, XIII, XV, XVI
[1] Net of MFT refunds.

Professor Racster makes the following forecast concerning highway revenue and expenditures in Illinois:

"The large amounts of future revenue devoted to improvement of the federal aid highway systems coupled with the demonstrated tendencies of other disbursements made by the Division of Highways to increase over time indicates that state highway revenues will not increase more rapidly than expenditures. The prospect of increased maintenance and operation expenditures necessitated by further development of the Interstate System supports this contention."

8. Consolidated Estimate and Projection of State Expenditures through the 1969-1971 Biennium

Table 5 on page 19 consolidates the Commission's estimates and projections of the total non-highway expenditures of the State of Illinois through the 1969-1971 biennium. This summary is based upon the research studies previously referred to in this report supplemented by the research of Professor Case M. Sprenkle. These estimates and projections are based on 1961 dollars—additional inflation, if any, will, of course, increase the amounts shown in the table. While the table takes into account the rising cost of existing services furnished by the State, it does not take into account the cost of new services. The cost of such services will be in addition to the costs shown in the table. It should also be observed that the item of cost shown for Common schools is only the cost of the equalization and flat grant aid. Additional Common school costs are included in the heading "All Other Expenditures."

The category "All other expenditures" in Table 5 can be explained by reference to the following expenditures under this category for the 1959-1961 biennium which totaled $303 million. Those expenditures which were over $10 million are as follows:

Secretary of State—Gen. Rev. Fund	$ 11 million
Dept. of Agriculture—Various Funds	22 million
Dept. of Conservation—Various Funds	21 million
Dept. of Public Works-Non Highways—Gen. Rev. Fund	13 million
Dept. of Revenue—Gen. Rev. Fund	15 million
Youth Commission—Gen. Rev. Fund	17 million
Illinois Veterans Commission—Gen. Rev. Fund	14 million
State Treasurer—Var. BIR Funds	39 million
Supt. of Public Instruction—Gen. Rev. Fund & Dr. Ed.	49 million
Dept. of Registration and Education—Gen. Rev. Fund	11 million
School Building Commission	10 million
Total	$222 million

There were 46 additional categories which made up the remaining $81 million of expenditures. It will be observed that common school costs, other than flat grant and equalization aid, totaled $49 million.

TABLE V

Total State Non-Highway Expenditure Projections (Millions of 1961 dollars)

	63-65			65-67			67-69			69-71		
	High	Medium	Low	High	Medium	Low	High	Med.	Low	High	Med.	Low
Vocational Education Ralph O. Gallington	14.1	10.2	6.2	22.9	16.3	9.7	28.5	20.1	11.7	33.7	23.5	13.7
Public Assistance Expenditure Glenn W. Fisher	478.3	429.9	376.2	582.5	492.5	417.1	709.6	559.0	460.5	867.4	628.9	505.7
Higher Education William P. McLure	445.1	422.0	402.9	555.5	525.4	495.1	707.0	656.9	601.3	822.5	731.0	644.0
Public Safety Glenn W. Fisher	55.2	43.4	31.7	43.9	38.8	33.9	47.2	41.7	36.2	42.8	40.5	38.4
Public Health Glenn W. Fisher	19.6	19.6	19.6	20.2	20.2	20.2	20.7	20.7	20.7	21.3	21.3	21.3
Mental Health Glenn W. Fisher	287.8	272.8	247.8	325.8	315.8	285.8	348.6	328.6	308.6	371.6	351.6	331.6
Common Schools Lawler, Bach, & Griffin	430.0	425.4	420.8	510.6	493.0	475.3	588.3	548.2	508.1	655.9	596.7	537.4
All Other Expenditures Case M. Sprenkle	455.3	427.2	399.0	556.6	506.6	456.6	680.4	601.4	522.5	831.7	714.8	597.9
Total Expenditure Projections	2185.4	2050.5	1904.2	2618.0	2408.6	2193.7	3130.3	2776.6	2469.6	3646.9	3107.8	2690.0

CHAPTER III

ESTIMATES AND PROJECTIONS OF THE YIELD OF EXISTING STATE TAXES

In making estimates and projections of the yield of existing State taxes the Commission has not taken into account the improved procedures for collecting the Retailers' Occupation taxes and related taxes enacted as emergency measures by the present session of the Illinois General Assembly. These measures had not been enacted at the time the Commission's research reports were prepared and their effect on tax collections is as yet unknown.

The actual revenue of the State of Illinois, adjusted to the 1961 value of the dollar, for the years 1951 through 1961 are shown in Table 2 on pages 22 and 23. The estimates and projections of expenditures were made by Professor Case M. Sprenkle.

TABLE 2

Adjusted Revenues[1]

Millions of 1961 Dollars

Year	ROT	Liq. Gal.	Pub. Util.	Cig. Tax	Ins. Tax	Inher. Tax	Corp. Franchise	Ill. Cent.	Racing Taxes	Int. on Funds	Misc. Fees & all other Receipts
1951	400.1	39.1	25.4	44.0	13.9	10.5	4.9	5.8	13.0	2.8	37.8
1952	390.0	31.8	26.3	43.8	28.2	13.2	4.7	5.6	15.1	2.3	31.4
1953	411.3	34.4	27.9	46.0	22.5	14.2	5.0	5.7	18.8	3.4	36.5
1954	412.5	34.4	30.3	46.7	24.8	13.8	5.3	5.3	17.6	3.6	43.9
1955	402.0	32.4	33.0	44.1	21.9	16.9	4.8	4.9	18.8	2.4	43.8
1956	391.4	36.1	35.7	47.3	28.8	22.0	6.5	5.2	19.4	2.8	43.7
1957	445.8	34.5	37.1	47.0	27.4	21.6	5.3	4.9	19.5	4.0	43.8
1958	423.5	32.6	39.0	50.0	24.1	21.3	5.4	4.3	18.5	4.9	64.3
1959	424.5	33.9	40.8	50.1	33.6	21.8	6.9	4.3	17.8	4.2	63.1
1960	416.7	32.2	45.5	50.2	29.3	22.4	5.7	4.0	18.2	6.1	64.5
1961	425.1	41.0	47.0	51.5	31.4	33.8	7.7	3.6	18.5	7.1	63.0

TABLE 2 (Continued)

Year	Tot. State Non Hy.	Motor Fuel Tax	Motor Veh. Dr. Lic. Auto Title	Total State Rev.	Local Property Tax	Local Fees & Misc. Receipts	Total Local Rev.	Tot. State & Local Non-Hy.	Total State & Local	Fed'l. Hgy. Aid	Fed'l. Wel-fare Aid	Other Fed'l. Aid	Total Non-Hy. State, Local & Fed. Aid	Total State, Local & Fed. Revenue
1951	741.5	125.2	71.1	937.8	1031.2	226.0	1314.4	2055.9	2252.2	16.7	59.4	27.5	2142.8	2355.8
1952	733.0	119.5	72.6	925.2	1079.4	229.2	1364.4	2097.4	2289.6	23.0	62.6	31.1	2191.1	2406.3
1953	774.0	124.1	77.8	977.0	1092.0	235.6	1386.4	2160.4	2363.4	31.2	61.9	29.1	2251.3	2485.5
1954	787.0	127.4	81.2	995.4	1085.5	240.7	1385.1	2172.2	2380.1	30.1	68.7	26.9	2267.7	2506.7
1955	770.0	134.5	83.3	988.8	1105.7	248.0	1411.1	2181.1	2399.8	30.2	72.6	23.7	2277.4	2526.3
1956	776.6	138.4	90.4	1005.4	1151.5	253.6	1461.1	2237.7	2466.5	41.4	66.9	27.2	2331.8	2602.0
1957	848.3	140.0	98.6	1086.9	1156.6	254.9	1475.2	2323.5	2562.1	39.2	73.6	31.9	2428.9	2706.7
1958	848.1	141.1	97.9	1007.1	1225.5	256.7	1542.8	2390.9	2629.9	56.9	78.0	36.7	2505.6	2801.5
1959	853.7	142.4	100.2	1096.4	1245.9	263.8	1570.4	2424.1	2666.8	116.2	82.0	43.5	2549.6	2908.4
1960	851.9	144.5	103.6	1100.0	1292.8	270.0	1622.3	2474.2	2722.3	200.2	99.0	42.7	2615.9	3064.2
1961	890.4	147.5	104.9	1142.9	1308.3	278.4	1647.5	2537.9	2790.4	177.5	96.6	46.5	2681.0	3110.9

[1] Adjusted for changes in tax rates and bases to reflect revenue which would have been obtained in each year with 1962 State tax rates and bases. Includes estimated receipts from SOT and Hotel and Motel Tax.

The Commission's revenue estimates and projections for the State and for local governments through the 1969-1971 biennium is shown in the following table. The accompanying table is based upon existing taxes, fees and charges and does not assume the levy of any new taxes.

TABLE 3

Biennium Revenue Projections
Millions of 1961 Dollars[1]

	63-65				65-67				67-69				69-71			
	Low 2.8%	Low 3.5%	Med. 4.0%	High 4.7%	Low 2.8%	Low 3.5%	Med. 4.0%	High 4.7%	Low 2.8%	Low 3.5%	Med. 4.0%	High 4.7%	Low 2.8%	Low 3.5%	Med. 4.0%	High 4.7%
ROT., SOT., Use and Hotel	1104.8	1124.9	1132.0	1142.7	1121.4	1152.1	1166.8	1188.9	1138.5	1174.2	1196.7	1231.1	1146.1	1199.8	1231.4	1278.8
General Revenue excluding Com. School	1434.8	1483.3	1504.5	1537.1	1488.5	1563.4	1608.8	1678.8	1544.2	1629.6	1700.8	1813.3	1602.0	1710.2	1811.5	1972.2
General Revenue including Com. School	1590.6	1644.2	1667.6	1703.7	1646.7	1729.3	1779.4	1856.6	1704.7	1798.8	1877.2	2000.1	1764.9	1883.9	1995.0	2171.6
Tot. State Non-Highway	1804.2	1864.8	1891.3	1932.0	1875.6	1969.4	2026.2	2113.8	1949.8	2057.1	2146.3	2287.3	2027.0	2163.4	2290.4	2492.3
Motor Fuel	317.3	329.4	334.5	342.4	330.8	349.6	360.7	377.6	344.8	366.7	384.1	411.6	359.5	387.6	412.4	452.1
Tot. State Revenue	2360.4	2454.6	2493.7	2553.9	2463.2	2610.0	2694.6	2824.5	2570.5	2740.8	2874.9	3089.3	2682.3	2901.5	3092.9	3511.8
Local Property Tax	2843.3	2945.2	2993.9	3069.1	2981.4	3139.5	3245.2	3408.0	3126.3	3304.1	3471.7	3737.6	3278.3	3506.7	3746.6	4132.8
Total Local Revenue	3568.4	3689.5	3747.9	3838.0	3734.5	3921.8	4048.3	4242.6	3908.2	4118.1	4318.0	4634.3	4090.1	4359.1	4644.4	5102.1
Total State and Local Non-Highway	5361.2	5553.8	5638.8	5769.4	5591.3	5890.3	6073.6	6354.5	5831.3	6173.8	6462.8	6918.6	6081.5	6520.6	6932.4	7589.8
Total State and Local Revenue	5924.8	6144.3	6241.8	6392.1	6191.2	6532.2	6743.2	7067.5	6469.4	6959.9	7193.3	7721.1	6760.3	7261.4	7737.8	8501.5
Total Non-Highway State, Local, and Federal Aid	5708.7	5908.0	6003.0	6149.4	5977.2	6286.0	6455.8	6807.9	6258.6	6605.5	6892.6	7446.0	6553.1	6997.3	7421.4	8208.7
Total State, Local and Federal Aid	6779.2	7062.1	7201.6	7417.1	7182.3	7624.8	7931.8	8406.2	7609.3	8107.4	8600.0	9387.1	8061.5	8706.5	9421.4	10584.1

[1]Projected on the basis of Illinois personal income projections. The first column for each biennium is based on the assumption that personal income in Illinois will increase at an annual rate of 2.8%. This rate is the average for Illinois for the decade 1951-1961. The last three columns are based on the assumption that Illinois personal income will grow at the rates of 3.5%, 4.0%, and 4.75% respectively. These latter rates are based on the projections of Ferber and Ford.

CHAPTER IV

THE ESTIMATED GAP BETWEEN STATE NONHIGHWAY REVENUE AND EXPENDITURES

Based upon the data previously discussed in the report and assuming no new State services and no new State taxes, and without giving effect to the improved tax collection measures recently enacted by the Illinois General Assembly, the Commission estimates and projects the following gaps or deficiencies between State revenue and expenditures through the 1969-1971 biennium as shown in the accompanying table:

TABLE 1

GAPS

State Nonhighway Revenues — Expenditures

Millions of 1961 Dollars

	63-65	65-67	67-69	69-71
I Low Expenditures				
A. Low Revenues	– 39.4	–224.3	– 410.5	– 526.6
B. Medium Revenues	– 12.9	–167.5	– 323.3	– 400.2
C. High Revenues	+ 27.8	– 79.9	– 182.3	– 197.7
II Medium Expenditures				
A. Low Revenues	–185.7	–439.2	– 719.5	– 944.4
B. Medium Revenues	–159.2	–382.4	– 630.3	– 817.4
C. High Revenues	–118.5	–294.8	– 489.3	– 615.5
III High Expenditures				
A. Low Revenues	–320.6	–648.6	–1073.2	–1483.5
B. Medium Revenues	–294.1	–591.8	– 984.0	–1356.5
C. High Revenues	–253.4	–504.2	– 843.0	–1154.6

Since the table is prepared in terms of the 1961 value of the dollar, the foregoing must be increased by the amount, if any, by which inflation reduces the 1961 value of the dollar.

CHAPTER V

POSSIBLE NEW SOURCES OF REVENUE WHICH THE COMMISSION PRESENTS WITHOUT RECOMMENDATION

The Commission recommends several new sources of revenue which are included in the list of Recommendations of the Commission hereafter set forth in Chapter VI of the report. As to all other new sources of revenue studied by members of the Commission's technical staff the Commission states, without recommendation, a brief argument in favor of and against the new tax and also states its estimated productivity. The possible new taxes thus considered are as follows:

1. General Service Tax

The Illinois Retailers' Occupation tax and related taxes are based on the gross receipts from the sale or use of tangible personal property. If a similar tax were levied on the gross receipts from the sale of services, such tax would produce a large amount of State revenue. In his research paper "Sales and Use Taxes" Professor A. James Heins estimates that a general service tax would produce about $223 million per year or $448 million per biennium, broken down as follows:

Service	Annual tax increment (millions of dollars)
Personal:	
Laundries	$ 9.0
Beauty and barber shops	5.4
Shoe repair	.5
Funeral services	2.0
General garment repair and storage	1.0
Auto repair	7.9
Auto parking	1.1
Electric repair	3.5
Watch and jewelry repair	.3
Reupholstery	.5
Miscellaneous repair	2.5
Motion pictures	1.6
Other amusements	5.9
Photo studios	1.6
Miscellaneous personal services	.7
Total personal services	$ 43.4

Professional:	
Physicians	$ 17.0
Hospitals	19.9
Dentists	5.5
Other medical services	2.5
Opthamolic and orthopedic	3.7
Brokerage and investment counseling	4.1
Bank service charges	2.6
Legal services	5.2
Total professional services	$ 60.5
Business services including advertising printing, etc.	$ 60.0
Taxes now lost because equipment has been declared custom made and hence primarily a service	$ 60.0
TOTAL	$223.9

He states that these estimates are optimistic to the extent of about 10%, so a more realistic estimate from the yield of the General Service Tax would be about $200 million per annum or about $400 million per biennium.

The high yield and broad base of a General Service Tax are the strongest arguments in favor of its adoption. Its regressivity and failure to reach income from investments are the strongest arguments against it. Also the taxing of hospital and medical services is certain to meet strong objections from the citizens of Illinois. Nevertheless, a General Service Tax is certain to receive careful attention as the need for substantial amounts of revenue increases.

2. Graduated Individual Net Income Tax

While it is unlikely that a graduated net income tax can be levied without a constitutional amendment, the Commission has stated the probable yield of such a tax on the assumption that the income tax laws of selected states were adopted in Illinois. On this assumption the following individual income tax laws, if adopted in Illinois, probably would produce the following amounts of revenue per year:

Alaska	$378,000,000
California	150,000,000
Oregon	600,000,000
New York	426,000,000
Wisconsin	426,000,000

An Illinois individual income tax law based on a percentage of Federal income taxes paid would produce about $28,000,000 per year for each 1%

of rate. An Illinois individual income tax law based upon Federally defined adjusted gross income less deductions and dependency allowances would produce about $125 million per year for each 1% of rate.

The arguments for a graduated income tax are that it is productive and "progressive," that is, it bears heaviest on those best able to pay. The arguments against such a law are that the Federal government has preempted the field and, in the opinion of many, grossly abused this tax by reason of confiscatory rates. The people of Illinois are apparently strongly opposed to this tax as is evidenced by the platforms of both major political parties which state an opposition to a graduated income tax.

3. Flat Rate Income Tax

A flat rate income tax in Illinois with no deductions except for expenses incurred in producing income may or may not be constitutional under the present Article IX. In the opinion of many attorneys such a tax can be imposed without a constitutional amendment. If adopted in Illinois a flat rate income tax would probably produce annually the following amounts for each 1% of rate:

Corporations	$ 26,000,000
Wages, salaries and unincorporated business	193,000,000
Dividends and interest	8,000,000
Total	$227,000,000

The tax on types of income other than those listed above might well raise the foregoing total to as much as $250 million per year or $500 million per biennium.

The arguments for and against a flat rate income tax are the same as those for and against a General Service Tax and the Retailers' Occupation Tax and will not be repeated here. A flat rate income tax has an additional argument in its favor by reason of the fact that it reaches income from investments, not reached by a Retailers' Occupation Tax or a General Service Tax, and is therefore more equitable.

4. Mortgage Recording Tax

Several states have mortgage recording taxes. That of the State of New York is the most productive. If the New York tax were adopted in Illinois the estimated yield is about $13 million per year or $26 million per biennium.

This tax has little to commend it because it falls heavily upon homes which are already burdened with property taxes. It does, however, produce rather substantial revenue and is easy to administer.

5. Classified Tax on Intangibles

This tax could not be adopted in Illinois without an amendment to the Illinois constitution. The most successful classified tax on intangibles is that in effect in Ohio. If the Ohio law were adopted in Illinois and assuming that Illinois could obtain the same efficient enforcement as Ohio has obtained, such a tax would yield about $75 million per year which presumably would go entirely to local governments. This amount is about double what is presently obtained from intangibles under the general property tax.

In spite of Ohio's success it is doubtful if intangibles can be taxed as efficiently under a property tax as under some form of taxation based on yield or income.

6. Severance Taxes

A severance tax of 5c per ton on coal and 5c per barrel on oil would produce about $6 million per annum or $12 million per biennium. Ease of administration is the chief advantage of severance taxes. In view of the fact that both coal mining and oil production are declining industries in Illinois, such a tax might well place Illinois companies at a competitive disadvantage and create further unemployment in the southern part of the State.

7. Tax on Stock Transfers and Commodity Futures

A transfer of 4c per share imposed on transactions on the Midwest Stock Exchange would produce about $1,750,000 per year or about $3,500,000 per biennium based on the number of shares presently traded on this exchange. A tax of 1/20th of a cent per bushel on grain future trades on the Chicago Board of Trade would produce about $9 million annually or about $18 million biennally. Such taxes would seriously effect the operations of these great markets and might well destroy them. The disruptive effect of these taxes is so great that they should be placed in the category of nuisance taxes.

CHAPTER VI

RECOMMENDATIONS

The Commission makes the following recommendations to the Illinois General Assembly and to the appropriate officers and agencies of the State Government:

COMMON SCHOOLS

1. The Commission recommends that in view of the fiscal situation of the State for this biennium, no changes be made in the foundation level or qualifying rates or flat grants.

Because of the increased number of school children the present foundation level, qualifying rates and flat grants will require up to $44 million in additional State funds without any change in the basis for State aid. The Commission feels that additional State aid to schools must await additional sources of revenue, out of which increased State aid can be paid.

2. For the future the Commission recommends that an increased share of the cost of education shall be borne by the State.

The Commission feels that the burden of local property taxes is already so heavy that it not be further increased. Since the cost of education is certain to increase in the foreseeable future, the Commission feels that this increased cost should be borne by the State and thereby grant a measure of relief to local taxpayers. This increased share of school costs which the Commission is recommending should be borne by the State must, of course, be borne out of additional revenue made available to the State of Illinois.

3. The Commission recommends that State support be withdrawn from the driver education program and that if the schools choose to continue this program it should be locally financed.

The Commission feels that State aid to schools should primarily be used for academic and vocational purposes. While the driver education program is admittedly useful, and Commission feels that it does not have the same priority as academic and vocational subjects and should be financed locally if the local school districts have funds for that purpose.

4. The Commission recommends that the existing driver's license charge be retained and put into the general revenue fund.

This recommendation will make the proceeds of the charge available to the general revenue fund where the increased need for revenue presently exists.

Senator Laughlin and Mr. Mathias dissent from recommendations from No. 3 and No. 4. Mr. Mathias states the following reasons for his dissent:

"In my opinion, the driver education program has proven its value.

The Commission singles out only one of the non-academic instruction programs authorized in Article 27 of The School Code. The operator's license fee was increased $2.00 to finance this program."

5. The Commission recommends to the General Assembly that consideration be given to a study of the academic achievements of the Illinois Public Schools through uniform state-wide achievement tests in order to measure the productivity of our educational system; that in connection with that study, attempts should be made to improve the academic standards of our schools and as a result of those tests minimum standards of achievement should be adopted and that appropriate steps be taken to bring achievements up to the minimum State levels as a condition of receiving State aid.

At the present time we have no standard against which the results of our Public School educational system can be measured. Charges have been made that college freshmen are poorly prepared and even more serious charges have been made that many graduates of our Illinois High Schools are unable to pass seventh or eighth grade achievement tests. The Commission feels that a state-wide system of testing would answer these charges and would enable the State to take proper measures to insure that satisfactory results are obtained from the large sums of money which we are spending on public education.

HIGHER EDUCATION

1. The Commission recommends that the tuition and student fees for Illinois resident students be raised to make them equal to the average tuition and fees charged in State universities in the Middle West for their resident students and that the tuition and student fees for nonresident, out-of-state students, be raised to a level comparable to the tuition and student fees charged by State universities in the Middle West for their nonresident, out of State students.

The research report on higher education indicates that the charges made in our Illinois State universities for tuition and student fees are low as compared to neighboring states. There is no reason why this situation cannot be corrected and a fair share of the cost of education be borne by the student himself.

2. The Commission recommends that the fiscal affairs of all State institutions of higher learning be controlled by a central board, namely, the Board of Higher Education, and that the General Assembly empower this Board to make fiscal allocations to the various State universities.

At the present time the Board of Higher Education has only advisory powers. The Commission feels that the lack of a central control in the distribution of State funds to the various State universities has, on occasion, resulted in excessive expenditures. If the Board of Higher Education were given mandatory allocation powers, as recommended herein, substantial economies might well result.

3. In view of the demonstrated ability of junior colleges to educate students for about one-half of what it costs in a university, and in view of the fact that Illinois will not have adequate facilities to take care of the increasing number of college-age students in this State, the Commission recommends that consideration be given to the creation of a system of junior colleges financed by the State, and that such colleges should be controlled by a junior college board and that a State bond issue should be voted and submitted to the people for the purpose of constructing these junior colleges.

The foregoing recommendation is supported by a research study which indicates both the need for and the economy of a state-wide system of junior colleges as compared to expanding the State universities to take care of the increased number of students. The junior colleges are not, however, intended to replace the first two years of the universities.

FEES, CHARGES AND OTHER NON-TAX SOURCES OF REVENUE

1. The Commission recommends that each department shall revise its fee schedule and where necessary, raise its fees to cover cost of services rendered.

A research report indicates that in many instances the fees and charges for services rendered by various agencies of the State have not been revised for many years and are too low to cover the cost of the service rendered. The Commission's recommendation would correct this situation.

STATE SALES AND USE TAXES

1. The Commission does not recommend that the Retailers' Occupation tax be taken off food sold in stores for preparation at home ("market basket" food.)

The research report indicates that taking the tax off market basket food will not only greatly reduce the yield of the Retailers' Occupation tax but will introduce serious administrative difficulties. Furthermore, the research report indicates that taking the Retailers' Occupation tax off the market basket food does not significantly lessen the regressivity of the tax.

INHERITANCE TAX

1. The Commission recommends that life insurance payable to a named beneficiary and subject to the incidents of ownership test presently used for Federal estate tax purposes, shall be included in the base for the Illinois inheritance tax.

In 1960 insurance death benefits in the amount of $239 million were paid in Illinois, 95% of which were paid to named beneficiaries and were not subject to the Illinois inheritance tax in its present form. Even after insurance policies where the decedent did not retain any of the incidents of ownership are excluded, the recommended change in the inheritance tax would substantially increase its yield.

2. The Commission recommends that jointly-owned property should

be included in the Illinois inheritance tax base under the same conditions that prevail under the provisions of the Federal estate tax.

At the present time only one-half the value of jointly owned property is included in the Illinois inheritance tax base. The recommended change will make the Illinois law consistent with the Federal law and also increase the yield of the tax.

3. The Commission recommends that the County Treasurer's fee be abolished and the tax be paid directly to the State Treasurer.

The Illinois inheritance tax is now paid to the County Treasurer who retains a 4% fee for collecting the tax and then remits the proceeds to the State Treasurer. Since the Illinois inheritance tax is a state tax it should be paid directly to the State Treasurer, and the County Treasurer's fee would thereby be eliminated.

HIGHWAY USER CHARGES

1. In view of the fact that it has been fourteen years since the formula for distributing the proceeds of the highway user charges has been established and in view of the growing burden of the State in maintaining the interstate highway system the Commission recommends that the formula for distributing the proceeds of highway user charges be studied for the purpose of making it more equitable under present and prospective conditions.

It would appear that the present formula for distributing the proceeds of highway user charges tends to distribute less to the State of Illinois than it should in view of the rising cost of highway maintenance.

2. The Commission recommends that consideration be given to increasing the motor fuel tax by one cent, the entire proceeds to go into the general revenue fund.

Forty-two states have a higher motor fuel tax than Illinois. A one cent per gallon increase in the tax would bring Illinois in line with the rate used by the greatest number of states. A one cent increase would produce about $29 million per year or about $58 million per biennium. The Commission believes that there is nothing in the nature of the motor fuel tax or in the nature of any other tax that requires its proceeds to be used exclusively for highway or for any other designated purpose.

Mr. Mathias dissents from this recommendation with the following statement:

> "I oppose increasing the motor fuel tax one cent, the proceeds to be paid into the general revenue fund. I feel it is unfair to increase taxes upon highway users, already heavily taxed, for general revenue purposes. This recommendation can only lead to further pressures for constitutional earmarking of highway user taxes."

3. The Commission recommends that consideration be given to increasing the tax on diesel fuel to more accurately reflect highway use.

Trucks get more mileage from diesel fuel than from gasoline. If the tax

is intended to be a measure of highway use then an increase of one cent per gallon is justified. Several states tax diesel fuel at a higher rate than gasoline.

4. The Commission recommends that the amount of annual automobile registration fees be increased and that the method of apportioning these fees be reexamined to establish a system on some basis other than horsepower.

Illinois automobile registration fees are low and the present method of basing the charge on horsepower is illogical. Weight, such as stripped down shipping weight, might be a more reasonable basis.

5. The Commission recommends that a reasonable service charge be imposed for reassignment of license plates and the Secretary of State be required to give a reminder of the privilege available.

The added expense caused by making a special reassignment of the same license number from year to year should be recaptured by a special additional charge for the service.

6. The Commission recommends that the mileage-weight option for trucks and buses be abolished.

Experience demonstrates that this mileage-weight option has been greatly abused and results in substantial loss of revenue.

Senators Eberspacher and Fox and Mr. Mathias dissent from this recommendation.

GENERAL CORPORATION TAXES

1. The Commission recommends that consideration be given to an increase in corporation taxes in accordance with the specific recommendations hereafter made.

Mr. Cushman and Senator Arrington dissent from the recommendations that corporations be singled out for tax increases on the ground that available evidence indicates that corporations are already paying their fair share of State and local taxes. Corporations should pay their share of broadly-based taxes but should not be discriminated against. They and the industry which they operate must provide the jobs which will cut down the burden of relief.

2. The Commission recommends that a change be made in the base of the existing corporation franchise tax so as to include earned surplus which will have the effect of doubling the productivity of the tax.

The present base of the corporation franchise tax is the amount of capital and paid-in surplus represented in the State. The research report presented to the Commission indicates that including earned surplus will double the base of the tax and make it more equitable. The present corporation franchise tax produces about $7 million per year or $14 million per biennium. The recommended change would, as indicated, double this yield.

Senator Arrington dissents from this recommendation.

3. The Commission recommends that the minimum franchise tax shall be raised to $50.

The present minimum franchise tax is $10. The Commission felt this minimum was too low and that it was worth at least $50 minimum to do business in Illinois as a corporation. The Commission has no data on which to base the amount of revenue which will be produced by this increase.

4. The Commission recommends as an alternative to recommendation No. 2 that rate of the present franchise tax be increased 300% and that the minimum tax be raised to $50 with the limits proposed at the last session of the Legislature. ($350,000 for Utilities; $200,000 for all other corporations)

This proposal, if adopted, would increase the yield of the present franchise tax from approximately $7 million per annum to $21 million per annum, or $42 million per biennium.

Senators Arrington and Laughlin and Mr. Cushman dissent from this recommendation.

5. As an alternative to No. 2 and No. 4, the Commission recommends that a corporate franchise tax measured by net income be imposed in lieu of the present Illinois franchise tax and capital stock tax.

The present corporation franchise tax, as has been previously stated, produces about $7 million per annum or $14 million per biennium. It is estimated that the capital stock tax on assessments made both by the Department of Revenue and the local assessors amounts to about $22 million per year, all of which is paid to local governments. It is estimated that a corporate franchise tax based upon net income earned in the State will produce about $26 million per annum per 1% of rate. Thus it would take about 1⅛% of rate to replace the existing corporate franchise and capital stock taxes.

Senators Arrington and Laughlin and Mr. Cushman dissent from this recommendation.

6. The Commission recommends that the administration of the capital stock tax be transferred to local assessors with the exception of the capital stock tax on local utilities.

The Commission felt that the wide disparity in the level of assessment of capital stock by the Department of Revenue and by the local Assessors could best be eliminated by transferring all but utility capital stock assessments, which require special knowledge, to the local assessors.

Senator Eberspacher dissents from this recommendation.

7. The Commission recommends that the rule of Hart v. Toman, 373, Ill. 462, (1940), be revised to provide that the shares of stock of a foreign corporation shall be subject to taxation unless 50% or more of the property of such corporation is located in Illinois.

In Hart v. Toman, 373 Ill. 462, the Illinois Supreme Court held that if

tangible property of a foreign corporation is assessed in Illinois the shares of stock of that corporation are not subject to taxation in Illinois. In the actual case over 97% of the foreign corporation's property was located in Illinois. The Department of Revenue and the local assessors construe the rule to mean that the shares of stock are exempt if *any* tangible property is assessed in Illinois. The Commission's recommendation will create a more equitable rule and one which is more in harmony with the Court's decision.

TAXATION OF INSURANCE COMPANIES

The Commission recommends that the General Assembly take appropriate measures to close the loophole of tax avoidance through the reinsurance of foreign corporations by domestic corporations if such a practice now exists.

There is some evidence that foreign insurance companies may be reinsuring in domestic companies for the purpose of avoiding the foreign insurance company premium tax. If this practice exists, then appropriate legislation should abolish it.

GENERAL PROPERTY TAX

1. The Commission recommends that legislation be adopted to require that county assessors be elected or appointed and that township assessors either be abolished or be brought under the direct supervision of county assessors.

There is much evidence that the township assessor system which exists in all counties in Illinois, except Cook, St. Clair and the 17 non-township counties in Southern Illinois is unsatisfactory and produces non-uniform assessments. The suggested change, if adopted, should greatly improve the quality and uniformity of assessments in township counties in Illinois.

2. If recommendation No. 1 is adopted the Commission recommends that it be implemented by restricting the power of the Board of Review to acting on complaints and by transferring equalizing power to the County Assessor.

This recommendation is already in effect in Cook County where it has produced satisfactory results.

TAXATION OF PUBLIC UTILITIES

1. The Commission recommends that the State utility tax be increased from 3 to 3½%.

The suggested increase would make the rate of the State utilities tax and the Retailers' Occupation tax and related taxes uniform. The proposed one-half cent increase would produce about $7½ million per annum or $15 million per biennium in additional revenue. The argument against the proposed increase is that public utilities in Illinois already pay four times as great a share of the total State revenue as the national average and a greater share than any state, except Rhode Island.

Senators Arrington and Laughlin and Mr. Cushman dissent from this recommendation.

TOBACCO, ALCOHOLIC BEVERAGES AND PARI-MUTUEL TAXES

1. The Committee recommends that consideration be given to an increase in the cigarette tax, proceeds to go into the general fund.

The cigarette tax produces about $25 million per one cent a package of rate per biennium. The rate could be increased as much as two cents per package without being out of line with similar tax in other states.

2. The Committee recommends that consideration be given to an increase in the tax on distilled spirits.

It is estimated that an increase of 50 cents per gallon in the Illinois tax on distilled spirits (or from $1.52 per gallon to $2.02) will increase the yield of this tax by about $4 million per annum or $8 million per biennium. The argument against this increase is that distilled spirits are already taxed at an excessive rate and any increase in the tax will encourage the production of illegal moonshine.

3. The Committee recommends that consideration be given to an increase in the tax on beer and wine.

The Illinois state tax on beer could be increased 10 cents per case of 24 bottles and not be out of line with similar taxes in other states. Such an increase would produce about $7 million per annum or $14 million per biennium. Wine is taxed at a low rate as compared to distilled spirits and beer (23 cents per gallon for an alcoholic content of 14%, or less; 60 cents per gallon for an alcoholic content of 14% to 21% with lower rates for wine made from Illinois-grown grapes). A 50% increase in the tax would produce about $1½ million additional per year or $3 million per biennium.

4. The Commission recommends that consideration be given to an increase in the tax on pari-mutuel betting.

The Illinois tax on pari-mutuel betting is low compared to other states. An increase of one percentage point in the rate would produce additional revenue of about $2.7 million per year or $5.4 million per biennium.

5. The Commission recommends that the State's share of the breaks, shall be increased and that this shall apply to all race tracks in the State, harness as well as flat track racing.

6. The Commission recommends that there be no increase or decrease in the race track owners' share of the betting dollar.

This recommendation means that any increased tax should come out of the winner's share.

7. The Commission recommends that consideration be given to supplementing the cigarette tax with a tax on all other tobacco products.

These other tobacco products are cigars, snuff, smoking and chewing tobacco. A reasonable tax on these products at the rates recommended in

the research report should produce about $6 million to $8 million per year or $12 million to $14 million per biennium. There are compliance difficulties in the case of cigars which may require amendment of the Federal Jenkins Act (requiring the reporting of interstate shipments of cigarettes) to make the State tax effective.

PUBLIC AID

The Commission recommends that the Illinois Public Aid Commission be abolished and that the supervision of public aid be placed in a code department headed by a director appointed by the Governor. Such director should be paid a salary and the Department of Public Aid should have provided for it an advisory counsel such as is provided for other code departments.

Without in any way reflecting adversely upon the individual members of the Illinois Public Aid Commission, the Commission feels that the responsibility for spending the huge sums required for public aid should rest with the Governor through a code department headed by a director appointed by and responsible to him. If the administration of public aid is good, the Governor should get the credit. If bad, he should take the blame. If the administration of relief becomes political, the voters can correct the situation by electing another governor. It is a fallacy to assume that administration is improved by separating the right to spend public money from the responsibility for raising it. This Commission believes that this recommendation, if carried into effect, should afford a basis for controlling the staggering relief costs which threaten the State's solvency.

Senator Eberspacher abstained from voting on this recommendation and expressed the view that he would prefer a nonpolitical commission of three or five full-time salaried persons to be responsible for the complete administration of the entire public assistance program and these commissioners should be directly responsible to the Governor and be appointed by him with the advice and consent of the Senate.

EARMARKED FUNDS

In accordance with the subcommittee's report, the Commission recommends that the General Assembly abolish at the earliest practical time all earmarked taxes that can legally be abolished.

Earmarking tends to deprive the General Assembly and the State officials of control over the expenditure of public funds. It tends to divert too much to some purposes; too little to others. No taxpayer has a right to insist that any particular tax be used for his benefit to the exclusion of other needed public services. The Commission's recommendation would not eliminate earmarking where required for Federal highway grants or where required by any bond ordinance or where required by the State constitution.

Senator Laughlin dissents from this recommendation.

In addition to the foregoing recommendations the Commission approved

the recommendations of the subcommittee on Economy Measures whose report is presented in full as Appendix A of the Commission's report (page 57 and following) which recommendations are as follows:

1. The Illinois Veterans Commission should be abolished.

As stated in the subcommittee's report, necessary aid and assistance to Veterans would continue to be supplied by the appropriate state agency or agencies to which the necessary functions of the Veterans Commission would be transferred.

2. The Spanish-American War Veterans Commission should be abolished.

It is felt no real need for this Commission still exists.

3. State financial support for State and County fairs should be reduced.

The subcommittee's report gives the reasons in support of this recommendation.

4. The marketing service projects of the Illinois Department of Agriculture should be curtailed.

Whatever essential functions are included among these projects should be performed by the University of Illinois and the rest should be abolished.

5. Conservation Education programs should be merged.

At the present time the Department of Public Instruction and the Conservation Department are both performing this educational program. Economies can be effected by a merger.

6. Various State programs relating to renewable natural resources should be merged.

The details of the suggested merger and the resulting economies are contained in the subcommittee report.

7. The so-called awards to breeders of Illinois thoroughbred colts should be eliminated.

The subcommittee's report explains why the awards should be paid by race tracks, not the State of Illinois.

8. The scope and expenditures of the Department of Aeronautics should be curtailed.

The essential function of this Department could be transferred to other departments for the reasons stated in the subcommittee's report.

9. The State costs of County Superintendents of Schools and assistants should be curtailed.

Assistant County superintendents of schools should be paid by the County which can then decide if they are necessary. Also study should be made as to the necessity of a County superintendent of schools where there is only one or a few school districts in a county.

10. The use of State-owned cars and State-owned garages should be curtailed.

A proper investigation of the cost of the use and repair of state-owned cars may well result in substantial economies.

11. The number and cost of State publications should be reduced.

State Agencies should be required to make a report of publications, the categories of recipients and the cost of the publications. A charge should be made for State publications which are requested by the general public. (Such as the Illinois Blue Book)

12. Prevailing wage laws should be modified.

The criticisms of the existing law and suggestions for improvement are stated in the subcommittee's report.

13. Data processing should be centralized.

Several agencies maintain expensive data processing equipment which is idle for more time than maximum efficiency allows.

14. State support of Bureau of Crime Prevention should be eliminated.

The State's support is small but the Bureau's work is largely informational and State support does not seem justified.

15. The State's support for the Northeastern Illinois Metropolitan Area Planning Commission should gradually be withdrawn.

This agency's work is commendable and effective. Nevertheless the Commission's work is local and it should be supported by a local tax which should be available to local planning agencies in all parts of the State.

16. More use should be made of prison made furniture and other items.

The State's prison furniture making facilities should be more fully used for furnishing State offices. Also, an investigation should be made to determine the savings from resuming prison manufacture of automobile license plates.

17. The cost of operation of Soldiers and Sailors Children's Home at Normal, Illinois, should be reduced.

The present cost averages $5,000 per child per year which is excessive. This cost should be substantially reduced.

18. The number of capitol guards should be reduced.

The Secretary of State maintains guards over the entire capitol complex and in addition, each elected official maintains duplicate guards for his office. The duplication should be eliminated.

19. The special appropriation for research for the elimination of tuberculosis should be abolished.

Started in 1947 as a temporary measure the appropriation is now more than five times as large as when first made. State support for this project should be withdrawn.

20. Economies recommended by the various offices and agencies should be placed into effect.

The subcommittee's report lists a number of economies suggested by various offices and agencies which might be effected. (These are set forth in Appendix A hereto.) The Commission recommends that every effort be made to put these suggested economies into effect.

CHAPTER VII

PROPOSED REVISION OF ARTICLE IX, THE REVENUE ARTICLE OF THE ILLINOIS CONSTITUTION

On March 20, 1963 the Commission on Revenue filed with the Governor and members of the General Assembly Part One of its Report consisting of Projections and Estimates of Revenue and Expenditures and Recommendations. In Chapter VII of the Report the Commission states that it was unable to agree upon a Revenue Article and, therefore, no recommended amendment to Article IX was included in its Report.

At the suggestion of Governor Kerner the Commission held several subsequent meetings and finally was able to agree upon and recommend by a vote of 8 aye, 6 no, one member abstaining, an amended Article IX, a copy of which is as follows.

A proposition to repeal Section 13 of Article IX of the Constitution, and to add a new section thereto known as Section 2A, and to amend Sections 3, 9, 10 and 12 of Article IX of the Constitution to read as follows:

ARTICLE IX

Section 2A. Notwithstanding the provisions of sections 1 and 2 of this Article the General Assembly:

1. May abolish the tax on tangible personal property or may direct that such property shall be uniformly assessed for taxation by valuation at a percentage of actual value not greater than the percentage used in assessing the highest taxed class of real property.

2. May levy or authorize the levy of use, privilege or franchise taxes, uniform within the territorial limits of the authority levying the tax, upon ships, boats and aircraft, and upon motor vehicles, or upon any class or classes thereof, in lieu of property taxes thereon.

3. May classify intangible personal property for taxation and may abolish the tax on any or all classes thereof. Classifications of intangible personal property shall be reasonable and based solely upon the nature and characteristics of the property and each class may be taxed in such manner as the General Assembly may direct by general law, uniform as to the class upon which it operates.

4. May classify real property for taxation. Classifications of real property shall be reasonable and shall be based solely upon the nature, characteristics or use by such property and each class shall be taxed by valuation in such manner as the General Assembly shall direct by general law, uniform as to the class upon which it operates. The highest ratio of assessed to fair cash value of any class of real property shall

not exceed three times the ratio of assessed to fair cash value of the lowest assessed class of real property.

5. Shall neither levy nor authorize the levy of a graduated income tax.

6. May levy a flat rate ungraduated income tax uniformly upon persons and corporations at a rate not to exceed five percentum with no deductions except expenses incurred in the production of income and personal and dependency exemptions not to exceed those permitted from time to time under the Federal Internal Revenue Code. If such a tax is levied, then no ad valorem tax shall be levied on tangible or intangible personal property after a date fixed by the General Assembly, which date shall not be later than 4 years after the effective date of the law levying such income tax.

Section 3. The property, both real and personal, and the income of the State, counties and other municipal corporations, household goods, and personal effects not used for the production of income, intangible personal property held in pension or welfare trust funds and the income therefrom, and such other property, as may be used exclusively for agricultural and horticultural societies, for school, religious, cemetery and charitable purposes, and the income of such organizations, may be exempted from taxation; but such exemption shall be only by general law. In the assessment of real estate encumbered by public easement, any depreciation occasioned by such easement may be deducted in th valuation of such proprty.

Section 9. The General Assembly may vest the corporate authorities of cities, towns, and villages, with power to make local improvements by special assessment or by special taxation of contiguous property, or otherwise. For all other corporate purposes, all municipal corporations may be vested with authority to assess and collect taxes; but such taxes shall be uniform, in respect to persons and property, within the jurisdiction of the body imposing the same, except as otherwise authorized by Section 2A of this Article.

Section 10. The General Assembly shall not impose taxes upon municipal corporations, or the inhabitants or property thereof, for corporate purposes, but shall require the corporate authorities to levy taxes for the payment of debts contracted under authority of law. Private property shall not be liable to be taken or sold for the payment of the corporate debts of a municipal corporation. The General Assembly may distribute in whole or in part, the proceeds of any tax levied by the State to such local governments and for such purposes as it may direct by general law.

Section 12. No county, city, township, school district, or other municipal corporation, shall be allowed to become indebted in any manner or for any purpose, to an amount, including existing indebtedness, in the aggregate exceeding five percentum or in the case of school districts maintaining grades one through twelve exceeding eight percentum, on the value of the taxable

property therein, to be ascertained by the last assessment for state and county taxes, previous to the incurring of such indebtedness. Any county, city school district, or other municipal corporation, incurring any indebtedness as aforesaid, shall before, or at the time of doing so, provide for the collection of a direct annual tax sufficient to pay the interest on such debt, as it falls due, and also to pay and discharge the principal thereof within twenty years from the time of contracting the same. In the event the tax on tangible personal property is abolished, the foregoing limitations of five percentum and eight percentum shall be increased to six percentum and ten percentum respectively.

Section 13 of Article IX of this Constitution relating to the World's Columbian Exposition, is repealed.

CHAPTER VIII

GENERAL OBSERVATIONS UPON THE ILLINOIS STATE AND LOCAL TAX SYSTEM

The Illinois State tax system is characterized by its heavy reliance on consumer taxes such as the Retailers' Occupation and related taxes and the Motor Fuel tax. The Illinois local tax system is characterized by its heavy reliance upon property taxes. In 1957 property taxes made up 51.7% of state-local tax revenue. By 1961 this percentage rose to 54.1%. The United States averages for these years were 44.6% and 46.3%, respectively.

The foregoing poses two policy questions for the Illinois General Assembly and for State and local officers and agencies:

1. Shall Illinois broaden its tax base for State purposes by including substantial revenue from nonconsumer taxes?

2. Shall Illinois increase its aid to local governments to a point where the burden of property taxes will be lightened?

It has been charged that the Illinois State tax system is regressive—that is, that it bears most heavily on those least able to pay. Standing alone this charge is valid. But viewed as a part of the National-State-Local tax picture the charge is not valid. The total effect of Illinois State taxes and the steeply graduated Federal taxes is a fairly equitable tax system wherein those most able to pay bear the greatest tax burden.

The new taxes recommended in this report will produce substantial revenue. If still more revenue is needed it appears that resort must be had either to a general or selective service occupation tax or to a flat rate or graduated income tax, assuming that any of these taxes can be levied under the present State Constitution. Sooner or later this choice must be made and the choice must be made by the State officials and the General Assembly, not by this Commission.

The need for relief for local property taxpayers is urgent but the real question is the availability of State funds for this purpose. Possibly the only practical way of relieving the local property taxpayer is to have the State bear an increased share of local school costs as this Commission has recommended. School costs are from 60% to 70% or more of local property taxes; so relief for property taxpayers in this way could be substantial.

Respectfully submitted,
COMMISSION ON REVENUE

APPENDIX A
REPORT OF SUBCOMMITTEE ON ECONOMY MEASURES

The Economy Measures Sub-Committee of the Illinois Revenue Study Commission has been charged with the responsibility of recommending specific areas for the elimination or curtailment of unnecessary expenditures of state money. In carrying out this assignment, the committee has heard from witnesses who were members of the public and who represented various interested organizations, as well as officials of state government. The committee has also gathered information and statistics from a Questionnaire directed to 60-odd state offices and agencies.

In an interim report issued September 16, 1962, the committee released a compilation of the many recommendations made to it from various sources. Since then, other suggestions have been made which are included in this report.

After its first report, the committee invited comments and appearances from representatives of the various agencies and functions affected by the recommendations. As a result of these further inquiries, some of the recommendations made to us have been refined and modified.

There are two major areas of state expenditure, touched upon in our original compilation of suggestions, which have been largely omitted from this report. They are Education and Public Aid. As these functions are the most costly, they contain many opportunities for more economical and efficient operation. It is believed that the potential for huge economies exists in these two areas, and they should be thoroughly studied and analyzed. However, since other committees and groups, both within and outside the Illinois Revenue Study Commission, are concentrating their primary attention on these two areas, our committee has confined its efforts to other, less obvious, services and functions of the government.

It is pointed out that many suggested economy measures are procedural in nature, and this may, indeed, be the direction in which lie the largest opportunities for economies in state government.

The Governor has pointed out to the committee, and to the General Assembly, the lack of any machinery in Illinois comparable to the federal Bureau of the Budget, or the California Budgetary Staff. The committee recommends that such a specialized division be established, responsible to and directed by the chief executive. Such a staff addition would be expected to produce a budget recommendation to the legislature much earlier in each regular session, and exercise much closer control over budget requests by the various departments and agencies.

Also, it is recommended that the Budgetary Commission enlarge its scope to perform the service contemplated by the statute which created it. As a legislative agency, it should certainly make the reports and particularize its recommendations to the general assembly, as intended for it to do.

Finally, the appropriation committees of the legislature are not properly organized or staffed to do any effective screening of appropriation bills. We recommend that these important committees be provided staff help, that the bills presented to them be made more uniform in order and form, and integrated into one bill for each office, department, agency or commission, to the full extent possible. It is further suggested that time "lags" be provided between hearings on bills and final committee action, to permit committee amendments to be drafted and presented. Members of the appropriations committee, in the House of Representatives at least, should be limited by rule to those who serve on only one other committee. More frequent meetings of these committees are called for, and scheduling should avoid conflicts with other committees, in order to insure maximum attendance.

The implementation of procedural reforms in the budget-making and appropriation processes, such as those recommended, will do much to eliminate waste and unnecessary cost in state government.

The committee makes one further general recommendation, not included in the following specific economy measures, but transcending them all. That recommendation is in the area of fees charged for various services provided by the state—i.e., student tuition at state schools, fees paid for inspectional services (factory inspectors, mine inspectors, sanitation inspectors, etc.), charges for use of state park facilities, agricultural reports and information services, state fair admissions, etc—which bears greatly on the portion of the cost of these services borne by the general public. Our state derives only about one-half of the income from fees that other states derive—on the national average of fee income to total income. An increase in our fee structure, to allow the user to pay a larger proportion of the cost of certain services, would mean a great saving to Illinois taxpayers. Studies should be made immediately of the adequacy of present fees, licenses and charges.

In conclusion, it is estimated by the committee that its recommendations, if adopted and effected, both specific and procedural, would result in reducing the cost of state government in Illinois substantially during the next biennium.

Submitted by Economy Measures Subcommittee

Rep. John C. Parkhurst	Sen. Russell Arrington
Sen. Everett Laughlin	Rep. Paul Elward
Mr. Verle Kramer	Dr. Norton Long

SUMMARY OF ECONOMY MEASURES

The following specific recommendations have been presented to the Economy Measures Subcommittee since its activation in April, 1962. They are the result of many hearings, a broad solicitation of expert opinion, and consideration of the viewpoints of those who would be most directly affected by the adoption of the recommendations. The Sub-Committee recommends that the Illinois Revenue Study Commission support these measures and recommends that they be specifically implemented in the budget presented

by the Governor for the 1963-65 biennium and carried out by the 73rd general assembly in its appropriations and with necessary legislation.

1. ABOLISH ILLINOIS VETERANS COMMISSION

Since its inception in 1945, the Illinois Veterans Commission has been of diminishing aid in processing and expediting veterans claims and providing liason with the various Veteran Administration offices of the Federal Government. However, it is now apparent that the vast number of veterans who needed special help and attention in these matters have now been served. An illustration of this realization is the recent abolition of the Cook County Veterans Aid Commission, and the inclusion of its functions within the Cook County Department of Public Aid.

It is recommended that the essential and necessary functions of administering state benefits for veterans be continued, and that state offices to serve the needs of veterans be maintained where necessary. However, it is also recommended that we immediately abolish the present state subsidies to selected veterans organizations in the form of outright grants ($37,100 for fiscal year ended June 30, 1962), and the employment of service representatives assigned to various veterans organizations in the state.

2. ELIMINATION OF SPANISH-AMERICAN WAR VETERANS COMMISSION

While the appropriation for this function is relatively small—only $12,000 a biennium—it is felt that a real need for this service no longer exists. It should be abolished as of December 31, 1964.

3. REDUCTION OF STATE FINANCIAL SUPPORT FOR STATE AND COUNTY FAIRS

(a) The Illinois State Fair is an institution which has been supported by public funds for many years, and provides a traditional focal point for the annual display of agricultural products and livestock, with a resultant impetus to the agricultural industry. However, in recent years there has been more and more emphasis on the commercial aspects of the annual state fair, and a resultant departure from the traditional idea of a showplace for Illinois farmers and breeders to display their wares.

A memo to the subcommittee by the state fair manager dated October 10, 1962, indicates that the attendance at the state fair increased by 125,000 visitors over the preceding year, and had a total attendance of 875,000 persons over the ten day period. Livestock entries increased 20% in 1962 over the preceding year and have increased 45% in the last two years.

Therefore, because of higher attendance and greater interest, a possible increase in the admission fee might be utilized to supplant the state money now being spent on the state fair. We recommend the abolition of the use of state funds for the purchase of tickets to any event at the state fair, and the abolition of free passes. It is recommended that the state fair become substantially more self sustaining and that steps be taken to accomplish this

in the '63-'65 biennium, and that extensive capital improvement programs on the state fair grounds, including private housing facilities, be carefully examined and controlled.

(b) It was recommended that the state subsidies for county fairs in Illinois be sharply reduced. In 1962 there were 104 county fairs subsidized in part by state funds. The law now permits subsidy of more than one fair per county, where fairs have been previously established and operative. Livingston County, for example, has four county fairs. This indulgence should be restricted so that there are no additional state supported fairs or expositions permitted for any county. A reduction in the various appropriations to support and subsidize county fairs is recommended for the biennium '63-'65. Some of the commission members believe that these reductions should be not less than 10%, and others believe this formula should be applied to all counties in the state.

4. CURTAILMENT OF MARKETING SERVICE PROJECTS DEPARTMENT OF AGRICULTURE

The need for extensive marketing research projects, carried on each year by the Division of Markets of the Department of Agriculture, usually under contract from the Department of Agriculture of the Federal government and partly supported by Federal funds, is questionable. For example, plans and recommendations have been or are being developed under this program for the improvement of the merchandising of dairy products, cottage cheese clinics, marketing improvements for fresh fruit and vegetables, including a recommended new facility for the better sorting and grading of apples, to be paid for by the Apple Growers Association. It is recommended that whatever essential research provisions are included among these functions be carried out by the College of Agriculture of the University of Illinois. The curtailing and streamlining of these appropriations could eliminate a substantial part of the $667,000 appropriation made to the Division of Markets for the 1961-63 biennium.

5. MERGE CONSERVATION EDUCATION PROGRAMS

The dissemination of information to the people of Illinois concerning the conservation of our natural resources, was formerly performed by the Department of Conservation exclusively. In 1957 the Conservation Education Division was formed in the office of the Superintendent of Public Instruction for disseminating this information through the schools of Illinois.

Now the Department of Conservation continues to disseminate educational information among the general public, and the Superintendent of Public Instruction disseminates similar information, supplied in part by the Department of Conservation, among the school children. Since the separation of functions, the total cost of the service has increased substantially, and each of the two divisions has grown. The 1961-63 appropriations for the respective divisions of the two departments were $281,000 (Conservation)

and $127,000 (Public Instruction). The committee recommends that these activities be again merged and a substantial reduction in the combined appropriations be applied to the 1963-65 biennium.

6. MERGING OF CERTAIN FUNCTIONS

The administration of the state's various programs relating to renewable natural resources should be integrated into a new department, following the recommendations made by the Illinois Agriculture Association, and the 1950 Commission to Study state government. The Director of the Department of Conservation, in a report to the committee dated October 22, 1962, stating that the combining of certain of these functions into a new department might lead to more efficient operation. The Committee believes that it might also lead to substantial economies, by eliminating duplication of effort, giving overall executive and administrative control to functions that are now largely autonomous (Natural History survey, Water survey, Geological survey, etc.), and priority projects could be more completely performed, while less essential projects could be deferred under a better system of priority planning. The various separate components performing these similar services were appropriated more than $5 million in the 1961-63 biennium, and it is recommended that the proposed new department into which these functions would be merged, should be curtailed substantially.

7. ELIMINATION OF PURSES FOR WINNERS AT CERTAIN RACES FOR ILLINOIS THOROUGHBREDS

The so-called awards to breeders of Illinois thoroughbreds is widely misunderstood. It is generally considered a subsidy for the Illinois horse-breeding industry, but its particular workings were explained to the committee on October 12, 1962, by the Director of the Thoroughbred Breeders Foundation. Changes in the law for 1947, requiring the Illinois race tracks to pay awards to breeders of Illinois thoroughbreds, were made in 1957 and 1959 to provide for larger purses at the Illinois race tracks to be supplied from the funds for Illinois bred thoroughbreds, in two races a week. To raise the money for the state-supplied purses at these special races, each licensed Illinois track was permitted an additional race each day, with the state drawing its regular share from the extra race and setting it aside for the purses for the two special races for Illinois horses. Only the winning Illinois horses share in the subsidy. This elaborate device to provide an incentive for breeding Illinois horses could be considerably simplified, it is believed, without affecting the desired result, if the state's contribution were eliminated and the earmarking feature abolished. The direct beneficiary of the decision to permit an additional race each day at all Illinois tracks is clearly the track owner, who enjoys a far greater share of the pari-mutual betting on the additional race than the part which goes to the state for the Illinois thoroughbred purses.

It is recommended that the burden of providing this incentive for Illinois breeders be shifted to the Illinois tracks which are the primary beneficiaries under the existing method. Such a revision would result in the same purses, prizes, and stakes for the winner of races limited to Illinois thoroughbreds, less extra income to the race track owners, and approximately $700,000 more in the next biennium for the State of Illinois.

8. CURTAILMENT OF THE SCOPE AND EXPENDITURES OF THE DEPARTMENT OF AERONAUTICS

Consideration should be given to abolishing the Department of Aeronautics and incorporating its essential functions within other existing departments or perhaps including them in a new Department of Commerce. The Department of Aeronautics administers grants for Illinois airports, for which matching funds are available from the federal government, and local funds. The share of this airport construction money appropriated by the State of Illinois for the 1961-63 biennium is four million dollars. This capital outlay is not within the province of the Revenue Commission to review. However, of the remaining $894,000 appropriated to support the Department of Aeronautics for this biennium it is believed that substantial savings may be achieved.

In the Executive Transportation Section which provides service by stated owned airplanes and pilot to various state executives, there should be clear lines drawn defining authorized personnel. Also the correlation of the airplane service and equipment available from the Department of Aeronautics and that available from the Department of Public Works should be studied and clarified.

Some of the other functions of the Department of Aeronautics, in the areas of safety education through pamphlets, charts, maps, etc., could be sharply curtailed.

It is recommended that the total appropriation for the 1963-65 biennium for the non-grant portion of the Department's budget be reduced substantially.

9. CURTAILMENT OF STATE COSTS OF COUNTY SUPERINTENDENTS OF SCHOOLS AND ASSISTANTS

In many counties, the duties of the County Superintendent of Schools can now be performed by the Superintendent of large school districts. In others, the Assistant County Superintendent, who is paid by the state, may be unnecessary. It is recommended that the salary of assistant superintendents be assumed by the individual counties, which now pay the other employees of the County Superintendent's office, thus permitting each county to decide whether an assistant superintendent is in fact necessary.

It is recommended that the School Problems Commission study the matter of consolidating or eliminating the office of County Superintendent

where the statutory duties of that office can be performed by local school district superintendents. The cost to the state for Assistant County Superintendents for the 1961-63 biennium was one and one-half million dollars.

10. CURTAILMENT OF STATE-OWNED CARS AND REPAIR GARAGES

The state of Illinois owns nearly 7,500 passenger automobiles. The state furnishes cars to great numbers of state employees whose use of them is in part personal. No clear lines of authorization or permitted use are set forth. What part of the operational cost of state highway garages—five million dollars for 1961-63—is allocable to repair of state owned vericles is not known.

It is recommended that:

(a) Comparative cost of rental cars for high-mileage users be investigated (state police cars, etc.).

(b) Personnel for whom automobiles are provided be clearly identified and limited (state officers, department heads, etc.)

(c) All other state employees be reimbursed for necessary use of their own automobiles only on travel vouchers clearly stating the date, places, and miles actually travelled on state business; and that automobiles available for other state employees who do not own their cars and must travel in connection with their work be kept in carpools and assigned out for specific trips only.

(d) All repairs of state cars be done under contract with commercial garages (except in case of emergency) and state-owned repair facilities be dispensed with.

11. REDUCE NUMBER AND COST OF STATE PUBLICATIONS

The cost of state publications is enormous, but no clear analysis or breakdown is available. There are no guide-lines or rules with respect to quantity or quality of state publications, and the amounts expended for printing and publications are largely within the discretion of the various state officers, department heads, and agencies. It is recommended that:

(a) Each agency and division which has an appropriation for printing summarize and file annual reports with an appropriate body (Auditor of Public Accounts, Budgetary Commission, etc.), showing what items were printed, the number of such items, and the cost. (Total and per unit or per page). Publications made mandatory by statute should be indicated. If mailed, the general categories of recipients should be indicated, (such as "members of general assembly," "school boards," "all public libraries," "all cities," "all counties," etc.), and the total number mailed.

(b) Charges should be made for many state publications requested by the general public, such as the Illinois Blue Book, the Illinois State Budget, etc. (The $5.00 fee imposed in 1961 for copies of the Legislative Digest drastically curbed demand for that publication).

12. PREVAILING WAGE LAWS SHOULD BE MODIFIED

The prevailing wage law now applies to the state of Illinois and generally to all local governments and contractors, in setting wages for employees engaged in the construction of public works. It has worked to establish unreasonably high pay scales for protected categories of employees in some localities, and led to inequitable results. Some members of the commission believe in the outright repeal of the prevailing wage law. All members believe that it should be modified and amended, so as to exempt persons in fact doing maintenance and construction work in state institutions and local institutions, who are employed on a continuing full time basis. It is suggested that it is not the policy of the state or local governments to permit or encourage below-standard wages for such work, or for any type of employees, but such a law creates discrimination and inflexibility, and leads to unnecessarily high costs to the taxpayer.

13. CENTRALIZE DATA PROCESSING

At present, several state agencies maintain separate data processing equipment for keeping records. This expensive equipment is not utilized to the maximum volume output, and is therefore idle for more of the time than maximum efficiency would permit. Centralizing the processing functions and sharing of the equipment by various offices should be studied. The avoidance of duplication very well could substantially reduce costs.

14. ELIMINATION OF STATE SUPPORT OF BUREAU OF CRIME PREVENTION

While the state's share of the cost of maintaining the Crime Prevention Bureau of Illinois is relatively small—$30,000 for the 1961-63 biennium—it would appear that this expense is not justified in terms of any perceivable effective result. The Bureau's activities are largely informational in nature, and the scope of the social, economic and governmental problems with which the Bureau concerns itself is so broad that the definitive purpose of crime prevention is difficult to perceive. It is recommended that the state appropriation for this purpose be eliminated. One member of the commission dissents from this recommendation.

15. WITHDRAWAL OF SUPPORT FROM THE NORTHEAST ILLINOIS METROPOLITAN AREA PLANNING COMMISSION

The planning program for the Northeast Illinois Metropolitan area is commendable and has been effective. However, its functions are being supported by appropriations totaling $150,000 for the 1961-63 biennium, through two state commissions, the Northeast Illinois Metropolitan Area Planning Commission, and the Northeast Illinois Metropolitan Local Governmental Service Commission. Since the planning function is a local matter, for the improvement and sensible growth of local communities, it is recommended that the financing of such programs be the responsibility of local counties and communities taking part in the planning function, and that a special

levy tax be authorized for financing local planning commissions in all parts of the state. The state subsidy for the Northeast Illinois Metropolitan Area Planning function should be gradually withdrawn, until it is totally supported by local tax contributions. Certainly, the support for two state commissions should be withdrawn, and it is recommended that one of the two above named commissions be abolished in the 1963-65 biennium.

16. USE OF MORE PRISON MADE FURNITURE AND OTHER ITEMS

The 1961-63 biennium budget appropriation—two and a half million dollars—is for office furniture and equipment. The state prison at Joliet manufactures new furniture and rebuilds old furniture. These furniture making facilities of the state should be fully utilized in supplying furniture and furnishings for state offices, and would substantially reduce the appropriation necessary for this purpose. Also, it is recommended that a careful investigation should be made to see if the state prison could manufacture license plates (as once was done), and reduce the cost of purchasing some or all Illinois license plates from private manufacturers.

17. ELIMINATION OF LEGISLATIVE SCHOLARSHIP PROGRAM

Now that the state of Illinois has embarked upon a substantial program of scholarships for students at institutions of higher education, based upon competitive examinations and need, it is believed that the traditional scholarships by appointment, available to members of the general assembly, and based upon personal choice only, should be abolished. It is estimated that the legislative scholarships now cost the state approximately $325,000 a biennium, in terms of tuition losses at the various state institutions.

18. REDUCE COST OF OPERATION SOLDIERS AND SAILORS CHILDREN'S SCHOOL AT NORMAL, ILLINOIS

The per pupil cost of this institution, formerly for orphans, but now for dependent children, is $5,000 per year. This is more than twice what it costs the average family to send a child to college for a year. The appropriation for the 1961-63 biennium was $2,733,600. It is recommended that operating costs of this school be substantially reduced.

19. REDUCE THE NUMBER OF CAPITOL GUARDS

Currently, the Secretary of State maintains guard operation daily over the entire capitol complex. In addition, the State Treasurer and other elected officers maintain duplicate sets of guards for their offices. An effort should be made to reduce the number of guards.

20. ELIMINATION OF SPECIAL APPROPRIATION FOR THE ELIMINATION OF TUBERCULOSIS RESEARCH

Instituted in 1947 as a temporary project, this appropriation has grown

from $32,000 to $173,000. It is recommended that the state support for this function be withdrawn.

* * *

The above and foregoing are recommendations gathered from the testimony of persons and organizations from outside the state government, who have voluntarily appeared before the committee, or filed written recommendations, or are suggestions of the committee members themselves. The following are recommendations made to the committee in response to a questionnaire which was sent to all state offices and agencies which have a continuing function, except the Illinois Public Aid Commission (being studied by other committees and groups), in July of 1962 and summarized in a report made to the committee by a research analyst on October 12, 1962:

Agency:	*Economies Recommended:*
Auditor of Public Accts.	1) Stop mailing travel warrants 2) Reduce microfilming of vouchers 3) Review check-off of union dues, contributions, etc. 4) Consolidate administration of the Burial Trust and Cemetery Perpetual Care Laws 5) Consolidate data processing equipment
Civil Service Commission	1) $900 savings would result by printing report biennially 2) New car would reduce costly repairs
Dept. of Aeronautics	None — but mentions that increasing costs have resulted from increased executive transportation.
Dept. of Insurance	1) Merging some divisions would bring "nominal benefits" (under consideration).
Dept. of Public Health, Bureau of Statistics Div. of Laboratories	1) New staff member would free administrators to undertake economy measures 2) Microfilming records (will soon start) 3) Consolidate activities in one building 4) Eliminate unnecessary tests 5) Laboratories could do some of the work done by the Depts. of Public Safety, Welfare.
Ill. Commerce Commission	1) Close Chicago office

Agency:	*Economies Recommended:*
Ill. Comm. on Human Relations	1) Chairman willing to forego $5000 salary
S.I.U.	1) Laws on detailed budgeting, construction bidding, and dues check-off have added to costs 2) Let S.I.U. retain locally its income fund rather than have to request reappropriation 3) Eliminate duplicate reporting of operational expenditures to Auditor and Dept. of Revenue
State Athletic Comm.	1) Eliminate one position
Univ. Civil Service Syst.	1) Cut down on reports (100) copies requested by Secretary of State 2) Data processing will cut record handling costs by two-thirds
U. of I.	1) Laws on detailed budgeting and bidding have been costly 2) Consideration of trimester or 4 quarter system 3) Raise fees substantially at Research and Educational Hospital in Chicago — $7,000,000 deficit could be largely eliminated, if not completely
University Retirement System of Ill.	1) Eliminate information handbooks given to employees. 2) Eliminate annual report
Tri-Cities	(Will be self-supporting after 1965)

In addition to the above listed economy measures as recommended by the agencies themselves in response to the committee questionnair, it should be noted that two state officers, the Auditor of Public Accounts and the Treasurer, have recommended further substantial economies in the operation of their offices. The State Auditor has estimated that he can save or lapse approximately $600,000 from his appropriation for the current biennium (approximately three million dollars was appropriated for the 1961-63 biennium).

The State Treasurer has recently recommended the reduction of expenditures in his office totalling $250,000 (total appropriation for operations $1,800,000 for 1961-63 biennium).

Minority Report by Representative John K. Morris —

Representative John K. Morris submitted the following minority report:

I hereby withhold my name from the Revenue Tax Study Commission report and submit the following minority report.

The Commission has made a detailed and extensive analysis of the revenue requirements in the State of Illinois over the next ten years. The need for additional revenue is not disputed and the amounts are realistic. However, the Commission was not only charged with stating the problem but was also obligated to come up with solutions. Instead, the Commission has made some piecemeal, patchwork recommendations, the effect of which can only be to compound the regressiveness of the Illinois tax structure.

The Commission duly noted the plight of property owners in this state, and the disproportionate share of the tax burden which falls on home owners, farmers and persons on retirement. Similarly, the Commission acknowledged that some 80% of the revenue of the state is derived from sales tax of one form or another. Notwithstanding this acknowledged imbalance, the effect of the Commission's recommendations is to make more disproportionate these very disproportions.

Additional money required for school needs in the next two years amounts to approximately $400,000,000. Of this increase, the state will absorb only $42,000,000; the local property owners will be asked to pay the rest through levies imposed by their school districts. While this division of tax responsibility confirms what Illinois *has* been doing, it is not what Illinois *should* be doing. Overall, the state picks up the tab of less than 25% of the school costs; the remainder comes from local property taxes; as to additional school revenues, this low proportion will steadily decrease as the state will only assume approximately 10% of each additional dollar spent. Given the increased needs detailed in the Commission report, there can only be a worsening of a very bad tax situation for the local property owner unless this formula is changed.

What is true about school needs is equally true in terms of other needs in the state. Mental health, welfare, vocational rehabilitation—all of these can be projected as requiring more funds over the next years. The solutions proposed by the Commission to these problems are dismal.

The Commission recommends an increase in cigarette taxes, liquor taxes, gasoline taxes, and other consumer oriented taxes. While the Commission does not so say, the plain fact of the matter is that even these taxes alone would not be enough to meet the needs. And the likelihood is great that a further increase in the general sales tax would be forthcoming as well.

It is not realistic to assume that the problem can be solved by drastically cutting spending in the vital areas of state government. The education of our children, the care and treatment of the mentally ill and the mentally defective and minimum subsistence for our needy citizens cannot be short-changed because of an unwillingness to propose needed revenue reforms. Illinois is a wealthy state, as the Commission report itself points out. To cut the vitals of programs such as mentioned above would be tragic and cannot be in the best interests of the people of the state.

I believe that the very composition of the Revenue Study Commission made it impossible for long range solutions to be found. The effort to get agreement from elements of the economy who do not want the present disproportion alleviated was doomed to failure. It defies human nature to expect the very elements who are not now paying their share of taxes to voluntarily agree to such reform. The same elements have resisted a revenue article which would give a broader scope to legislative power in this field. I believe it is fruitless to expect such commissions to resolve their differences in the kind of forthright manner that the revenue problems of this state require. It is like asking a committee made up of hotrodders and members of the Safety Council to work out a safety program.

Neither the executive branch nor the legislative branch can hide behind the Commission's refusal or inability to make specific recommendations in respect to revenue reform. The job of political leaders is to lead; that is what they were elected for. It is apparent to me that the leaders of both parties in Illinois in publicly announcing their platform stands against any form of state income tax are assuming an ostrich-like position. Until the political leaders become more interested in a progressive tax system and refuse to support further additions to the already burdensome and unfair property taxes and sales taxes, Illinois cannot move ahead. I believe that revenue reform cannot wait for a consensus of all the economic groups in our state. As with every other progressive reform, there will be opponents, and proponents must be willing to meet this opposition head on.

I recommend that the Legislature take a close look at the J. Nelson Young report made to the Revenue Study Commission. In this report, Young points out that Supreme Court rulings since 1932 strongly indicate that the Legislature has greater power in the field of revenue reform than some of the so-called experts have indicated. I suggest that the school people and representatives of agriculture, labor, small businessmen and the elderly pool their forces to make clear to the Legislature that immediate tax reform in Illinois is necessary and possible. We can have an income tax in Illinois now—perhaps a graduated one—certainly a flat-rate income tax with exemptions. The imposition of such a tax would not only meet the additional revenue needs in Illinois but would also do the following as well:

a. It would allow a substantial cut in property taxes by the State supplying its rightful share of school revenue needs.

b. It would allow a virtual elimination of the sales tax as the main source of state revenue.

c. It would provide a flexibility in meeting the revenue needs of the state as they occur.

The effect of such an immediate tax reform would be to restore a balance as to the impact of taxes on the diverse economic groups in our state—a balance that once existed and that has been destroyed by the failure of government to keep up with changes in our society.

It is significant that within the last few weeks the President of the United States in an unprecedented move requested a program for federal aid to mental institutions. The message points up the lesson we have refused to learn during the past 25 or 30 years and which the Revenue Study Commission has blinded itself to. That lesson is that unless the states meet their responsibility, a vacuum is created which the federal government must fill. Our political and business leaders deplore federal intervention and yet, at the same time, refuse to let the state shoulder its own responsibilities.

I think the time has come for the majority of the citizens of this state to express their strong objection to the status quo in revenue matters and to pool their efforts for tax reform now.

Additional Statement by Charles F. Conlon

Mr. Charles F. Conlon submitted the following Additional Statement in which Dr. Norton Long, Mr. Kramer and Mr. Mathias concurred:

These additional comments are designed to put in sharper focus the basic revenue problem faced by the State of Illinois so that efforts on the part of the Executive and Legislative Departments to deal with the fundamental issues will receive the broad public support they merit.

A review of the mass of data presented to the Commission shows that the Illinois revenue problem involves several more or less closely related issues. They include the incidence and adequacy of the present tax system; State-local fiscal relations and the relatively high proportion of the tax load carried by the property tax in the combined State-local tax system. The common thread binding all these issues together is the question of constitutional revision.

Incidence

The general sales tax is the basic revenue producer in the State system with an annual yield now running in excess of $450 million. The staff reports show the relatively severe impact of this tax on the lower income groups but this is only part of the picture because there is another $150 million or so which comes from special sales taxes falling wholly or substantially on personal

consumption (cigarettes, alcoholic beverages, and public utility services). Higher tax rates in this area will produce substantial amounts of new revenue but such action will also intensify the present maldistribution of the tax burden. As a practical matter, an extension of the sales tax to services generally would in all probability have a similar effect. Incidentally, the productivity of such an extension may be much less than its apparent potential because some types of services would almost certainly be excluded—medical, surgical, and dental, for example—while others are or may be put beyond the reach of the state's taxing power by performance elsewhere.

Adequacy

The staff projections (medium range estimates) of non-highway expenditures and anticipated revenues, assuming the State's present tax system remains unchanged in the next four bienniums, indicate that there will be a small gap between revenues and expenditures in the forthcoming biennium followed by a gradually increasing deficit which will amount to $817 million (or 36 per cent of projected non-highway revenue receipts) by the close of the biennium ending June 30, 1971 (Table 1). While the size of this projected deficit may be overstated—for one thing, improved sales tax collection procedures might make a substantial dent in it—the trend indicated by the projections is truly quite consistent with the fiscal experience of the period from July 1, 1949, to June 30, 1961, when the application of approximately $115 million of the World War II surplus, three increases in the sales tax rate, the enactment of a general use tax, the broadening of the base of the sales tax, and a variety of other tax increases were necessary to prevent the occurrence of comparable deficits. This shows up clearly in Table 2 which indicates the trend in general fund and common school fund revenues and expenditures over that period.

TABLE 1
Projections, 1963-1971, of State financed nonhighway expenditures, estimates of revenues from nonhighway taxes, fees and changes currently imposed (both medium range projections)

(millions of dollars)

Biennium ending June 30	Total nonhighway expenditures	Total nonhighway revenues	Deficiency	Deficiency as % of total revenue
1965	$2,050.5	$1,891.3	$159.2	8%
1967	2,408.6	2,026.2	382.4	19%
1969	2,776.6	2,146.3	630.3	29%
1971	3,107.8	2,290.4	817.4	36%

TABLE 2

General Fund and Common School Fund Revenues and Expenditures 1950-1961

(millions of dollars)

Biennium ending June 30	Revenue	Expenditure	Deficiency	Deficiency as % of revenue
1951	$ 568,884	$ 624,826	$ 55,942	9.0%
1953	640,976	675,346	34,370	5.3%
1955	672,625	699,348	26,723	4.0%
1957	859,349	830,359	+(28,990)	+(3.4%)
1959	958,977	991,675	32,698	3.4%
1961	1,153,680	1,225,196	71,516	5.8%

Note: Accumulated deficit $115 million in 1951-1953-1955 biennial periods met from World War II surplus. Sales tax rate increased from 2 to 2½% in 1955; from 2½% to 3% in 1959 and from 3% to 3½% in 1961. General use tax enacted in 1955 and sales tax base further broadened in 1961.

The inescapable conclusion is that the State's present tax and revenue system is not adequate to meet the demands which may reasonably be expected to be made on it in the next decade.

The corollary of the point that the present tax system bears heavily on the lower income groups is that the revenue yielded by this system constitutes a gradually decreasing proportion of personal income as one goes up the income scale. What is needed is the introduction of a factor which will apportion the tax burden more equitably in terms of income and which at the same time will make the system more responsive to increases in personal income. These effects can be achieved only by augmenting the present system with a net income tax that will bear at least proportionately on the middle and upper incomes. Depending on the rate chosen and other relevant details, the yield of such a tax might be sufficient to keep pace with the expenditure requirements of the coming decade without the constant beefing up of the system through rate increases and broadening of the base which has characterized the past several years. Additionally, the enactment of an income tax is a prerequisite to any mitigation of the burden of the sales tax by the exemption of food or otherwise as well as to any reduction or even stabilization of demands on the property tax.

STATE-LOCAL TAX RELATIONS AND THE PROPERTY TAX

The present division of tax responsibility between the State and its local governments tends to put increasingly heavy pressure on the property tax in Illinois. Local governments here raise over 61 per cent of combined State and local tax revenues compared to the national average of 51 per cent. Illinois

(38.6 per cent) is one of only six states where the proportion of taxes imposed at the State level is below 40 per cent—and the only industrial state besides New Jersey which is in that class. With local access to non-property taxes limited by legal and practical considerations, additional local revenue requirements, mostly for school purposes, are necessarily largely financed by the property tax.

Census Bureau data shows not only that the property tax is the major component of the Illinois State-local tax system but also that reliance on this tax source has increased in recent years—from 51.7 per cent of all State-local taxes in Illinois in 1957 to 54.1 per cent in 1961.

These considerations read in conjunction with the staff studies of the property tax suggest that action along the following lines would be constructive. First, since the State has access to a wider range of tax sources than do local governments and since it is in a better position to administer such taxes on a statewide basis, initial steps should be taken to change the present division of tax responsibility either directly by sharing some of the proceeds of State imposed taxes with local governments or indirectly through State assumption of a larger share of basic educational costs. Second, since in any event, the property tax is going to continue to be a substantial component of the State-local tax system, the General Assembly should be given the authority to classify personal property for tax purposes and to provide in lieu methods of taxation where appropriate. Third, the General Assembly should take steps to improve the administration of the property tax and to equalize the distribution of property tax burdens by providing a more effective measure of state supervision over property tax assessment procedures. This is a large order and the best chance of filling it lies in creation of a new state agency under the commission form whose three members would serve overlapping six-year terms. All duties relating to the supervision or assessment of property taxes now assigned to the Department of Revenue should be transferred to the new agency.

REVISION OF THE REVENUE ARTICLE

The extreme differences of opinion expressed in submissions to the Commission and in the Commission's own discussion of the subject suggest that any proposal to revise the revenue article of the constitution be limited to whatever is urgently needed right now. Careful consideration of two points brought out in the staff reports indicate that only one proposal meets this criterion, namely, an amendment to authorize the General Assembly to classify personal property for tax purposes. These two points are: (1) the practically unanimous view that the General Assembly is now prohibited from classifying personal property for tax purposes and that an amendment is absolutely necessary if this is to be done and (2) the existence of a substantial body of opinion holding that the General Assembly already possesses

rather broad tax powers (even though there is some disagreement about the precise extent of these powers), and that there is, therefore, no urgent need for constitutional amendments relating to non-property tax powers.

Accordingly, since property tax revision is the only area where constitutional revision is indispensable to effective legislative action, pragmatic considerations suggest that an amendment limited to the classification of personal property be drafted and submitted. This procedure would at least have the advantage of insuring that the property tax question would be considered on its own merits. There is no good reason to delay the submission of an amendment until one can be drafted to cover all the points that have been seriously urged because the proceedings in the Commission made it clear that there is no consensus on any kind of a manifold proposal. It follows that the constructive policy is to limit the amendment to the one area where revision is urgently needed in order to pursue a course of action, personal property classification, which appears to be widely favored.

Report of the Commission on Revenue

PART TWO

Research Report Submitted to the Commission*
by the Research Staff

*Responsibility for the factual materials and expressions of opinion which appear in the Research Report rests with the writer and not with the Commission. The recommendations of the Commission, together with explanatory materials and comments, are contained in Part One of this Report.

FOREWORD

In the following pages is presented the Research Report which was prepared by members of the research staff. The subjects included in the Report were selected by the Commission.

The primary purpose of the research studies is to present information and an analysis of facts to assist the Commission and the General Assembly in considering the desirability of changes in the state and local tax system and problems related thereto. It is hoped that these studies will be of interest to others who are interested in tax problems. The expressions of opinion and suggestions which appear in the various chapters of the Research Report are those of the author and do not necessarily reflect the views of the Commission. The recommendations of the Commission are presented in Part One of the Commission's Report.

On behalf of ourselves and other members of the research staff we wish to thank the numerous tax administrative officials of other states, Illinois State officials, local officials, private organizations and private citizens for the assistance which they have rendered in connection with the research program. Special thanks are due the Department of Revenue which contributed immeasurably to the work of the research staff.

The Director and the Assistant Director of Research are most grateful to the administrative officials and secretarial staffs of the University of Illinois, Southern Illinois University, Northern Illinois University, and Western Illinois University for their splendid cooperation and assistance with the research program, except for which the research studies could not have been made.

We desire to thank the members of the Commission for their cooperation and for the many courtesies extended to us and to other members of the technical staff during the progress of the research work. The Director and Assistant Director of Research also wish to take this opportunity to express their gratitude to the members of the research staff for their wholehearted cooperation in assisting with the Research Report. Whatever credit is due, should go to the individuals who wrote the various reports.

H. K. Allen, *Director of Research*
Vernon G. Morrison, *Assistant Director of Research*

June, 1963

CHAPTER I
THE PROJECTED ECONOMIC GROWTH OF ILLINOIS TO 1971

By Robert Ferber and Neil Ford*

Illinois is one of the wealthiest states in the nation. Its average personal income in 1961 was $2,676 per capita. This was 18 percent above the U.S. average and was exceeded by only six other states.

Moreover, Illinois is in many respects a virtual miniature of the United States. Within the borders of this state are located extensive urban and suburban areas as well as many different types of farm, industry, mining, trade, and financial enterprises. Not only is every form of economic activity represented in this state but the relative importance of these activities corresponds remarkably well with our relative importance in the country as a whole. To illustrate, the following tabulation compares the relative importance of the different industrial sources of civilian income in Illinois and in the United States in 1961, the most recent year for which such data are available.

Source	U.S.	Illinois
Farms	4.9%	4.1%
Mining	1.3	.8
Contract construction	6.4	6.3
Manufacturing	29.0	33.1
Wholesale and retail trade	19.2	20.0
Finance, insurance and real estate	5.3	5.4
Transportation	4.8	5.5
Communications and public utilities	2.9	2.7
Services	13.1	12.6
Government	12.7	9.3
Other	.3	.2
Total	99.9%	100.0%

As is evident from this tabulation, in Illinois as well as in the nation manufacturing is the principal source of income, accounting for roughly 30 percent of the total. Wholesale and retail trade comes next, representing one-fifth of civilian income in both the state and the nation, with service activities, government, and construction next in line. Indeed, the order of importance of the different sources of income is seen to be identical in both cases.

---

*Robert Ferber is Research Professor of Economics in the Bureau of Economic and Business Research and Professor of Economics in the Department of Economics of the University of Illinois. Neil Ford is Research Assistant in the Bureau of Economic and Business Research.

In view of this close correspondence, the future of Illinois is clearly linked inextricably with that of the nation. This is particularly so in view of the central location of this state, which means that any changes in economic conditions nationally are bound to affect Illinois. For purposes of economic forecasting this means that economic projections for the state must hinge on similar projections for the nation. This is the approach that has been taken in preparing the present set of projections. The first section of this report presents the assumptions and data underlying the projections of economic activity in the nation as a whole, while later sections focus on the implications of those projections for economic conditions in Illinois.

Prospects for the Nation

Long-range predictions of economic growth of the nation necessitate various assumptions regarding the political and economic environment which is likely to be encountered in the future. Clearly, under the present circumstances such assumptions are subject to large margins of error. In particular, changes in international politics could bring about pronounced effects on economic activity in this country. Similarly, it is very difficult at the present time to foresee the effects of the European Common Market and of other possible supranational authorities on conditions in this country.

To some extent, this uncertainty can be alleviated by constructing not one but three alternative projections. These three projections may be used to represent probable economic growth under favorable conditions, under conditions that appear to be most likely, and under unfavorable conditions; these projections will be denoted by "high," "medium," and "low." At the same time, certain basic assumptions underlie all of these projections, for without such assumptions these projections could hardly be made. In particular, it is assumed that:

1. There will be no appreciable change in the international political situation. In particular, there will be no major war or other cataclysmic event.
2. The development of the European Common Market and other supranational trading bodies will not affect appreciably the economic growth of this country.
3. No serious or prolonged depression will occur during the next decade which might retard the national rate of growth.

With the aid of these assumptions, we begin by projecting the future gross national product of this country, i.e., the total market value of the nation's goods and services. In the past 50 years our gross national product after adjustment for price increases has risen at the rate of 3 percent per year. The rate has been somewhat higher since World War II, having averaged 3.5 percent per year in the last decade.

Because of the increased emphasis on stimulating economic growth and the likely future accelerated utilization of the nation's resources, a somewhat

higher rate of increase appears to be likely for the next decade. Projections of this rate of increase have ranged generally between 4 percent and 5 percent. Considering the dampened rate at which the gross national product is likely to grow during the next year or two, the rate of increase for the next decade would seem likely to average around 4 percent per year. On the other hand, the rate of increase could be as high as 4.75 percent under favorable conditions or, if the anticipated acceleration of activity does not take place, the rate of increase might not be any higher than the rate in the past decade, or 3.5 percent.

These three rates form the basis for the projections of the gross national product shown in Column 2 of Table 1. As is evident from that table, by 1971 the gross national product, in 1961 dollars, is likely to be somewhere between $741 billion and $825 billion. In other words, the value of the nation's output of goods and services in that year is likely to be at least 40 percent higher than the figure for 1962, and could exceed this year's figure by more than 50 percent.

The implications of these estimates for the total income received by the American people is shown in Column 3 of this table. Based on past relationships, the increases shown in that column are assumed proportionate to the increases in gross national product.

The estimates given in these two columns can be translated to a per capita basis by dividing the figures by national population projections of the U.S. Bureau of the Census. Three such alternative projections are shown in Column 2 of Table 2 based on different assumed fertility rates of the U.S. population. As is evident from that table, the total population in 1971 is expected to be somewhere between 212 million and 224 million, the most likely figure, 217 million, representing an increase of 16 percent from the number as of mid-1962.

Dividing the medium population projections in Table 2 into the projected gross national product and personal income yields estimates of gross national product per capita and of personal income per capita, shown in Columns 4 and 5 of Table 1. As would be expected, the rate of increase in per capita gross national product and in per capita personal income is substantially less than the rate of increase in the corresponding national aggregates, because part of the increase in the latter represents population growth. The expected increase over the next decade in the per capita gross national product is 24 percent, with the likely range being between 18 percent and 32 percent. Similar rates of increase are expected in the future growth of per capita personal income.

Estimates of the total labor force in the last decade are provided in Column 3 of Table 2. The total labor force projections were arrived at by assuming that the labor force participation rate will remain approximately 40.6 percent. This rate is expected to change relatively little since the mem-

TABLE 1

Estimated and Projected Gross National Product and Personal Income for U.S., 1961 Prices, 1950-1971

(1) Year	(2) Gross National Product (Billions of Dollars)			(3) Personal Income (Billions of Dollars)			(4) Per Capita Gross National Product (Dollars)			(5) Per Capita Personal Income (Dollars)		
1950		366.5			283.9			2,413			1,870	
1951		396.5			298.9			2,574			1,940	
1952		411.7			311.4			2,631			1,990	
1953		430.6			325.4			2,708			2,046	
1954		422.0			323.8			2,606			2,000	
1955		455.1			345.1			2,757			2,091	
1956		464.8			363.8			2,766			2,165	
1957		473.6			373.0			2,768			2,180	
1958		466.1			374.9			2,678			2,154	
1959		497.5			395.0			2,809			2,230	
1960		511.3			406.1			2,830			2,248	
1961		521.3			416.4			2,837			2,266	
1962		543.6			435.0			2,913			2,331	
	High	Medium	Low	High	Medium	Low	High	Medium	Low	High	Medium	Low
1963	569.4	565.3	562.6	455.7	452.4	450.2	3,013	2,991	2,977	2,411	2,394	2,382
1964	596.5	588.0	582.3	477.3	470.5	466.0	3,099	3,054	3,025	2,480	2,444	2,421
1965	624.8	611.5	602.7	500.0	489.3	482.3	3,916	3,128	3,083	2,558	2,503	2,467
1966	654.5	635.9	623.8	523.7	508.9	499.2	3,306	3,212	3,150	2,645	2,570	2,521
1967	685.6	661.4	645.6	548.6	529.2	516.6	3,386	3,266	3,188	2,709	2,613	2,551
1968	718.1	687.8	668.2	574.7	550.4	534.7	3,478	3,331	3,236	2,783	2,665	2,589
1969	752.2	715.3	691.6	602.0	572.4	553.4	3,582	3,406	3,293	2,867	2,726	2,635
1970	788.0	744.0	715.8	630.6	595.3	572.8	3,691	3,485	3,353	2,954	2,788	2,683
1971	825.4	773.7	740.9	660.5	619.1	592.9	3,804	3,565	3,414	3,044	2,853	2,732

SOURCE: 1950-1962 data for gross national product and personal income from *Economic Indicators*, August, 1962.

TABLE 2

Estimated and Projected Population and Labor Force of the U.S., 1950-1971

(1) Year	(2) Total Population (Millions)			(3) Total Labor Force (Millions)			(4) Civilian Labor Force (Millions)		
1950		151.9			64.7			63.1	
1951		154.1			66.0			62.9	
1952		156.5			66.5			63.0	
1953		159.0			67.4			63.8	
1954		161.9			67.8			64.5	
1955		165.1			68.9			65.8	
1956		168.0			70.4			67.5	
1957		171.1			70.7			67.9	
1958		174.1			71.3			68.6	
1959		177.1			71.9			69.4	
1960		180.7			73.1			70.6	
1961		183.7			74.2			71.6	
1962		186.6			76.4			73.6	
	High	Medium	Low	High	Medium	Low	High	Medium	Low
1963	191.0	189.0	187.0	77.4	76.5	75.7	74.4	74.0	73.7
1964	194.0	192.5	190.0	78.6	78.0	77.0	75.6	75.5	75.0
1965	199.0	195.5	193.6	80.6	79.2	78.4	77.6	76.7	76.4
1966	203.0	198.0	196.0	82.2	80.2	79.4	79.2	77.8	77.4
1967	207.0	202.5	198.0	83.8	82.0	80.2	80.8	79.6	78.2
1968	211.0	206.5	202.0	85.5	83.6	81.8	82.5	81.2	79.8
1969	215.0	210.0	205.0	87.1	85.1	83.0	84.1	82.8	81.0
1970	219.5	213.5	208.2	88.9	86.5	84.3	85.9	84.2	82.3
1971	224.0	217.0	212.0	90.7	87.9	85.9	87.7	85.6	83.9

TABLE 2 (Continued)

(1) Year	(5) Military (Millions)			(6) Civilian Labor Force Unemployment Rate		
1950		1.6			5.3	
1951		3.1			3.3	
1952		3.5			3.1	
1953		3.6			2.9	
1954		3.3			5.6	
1955		3.1			4.4	
1956		2.9			4.2	
1957		2.8			4.3	
1958		2.7			6.8	
1959		2.5			5.5	
1960		2.5			5.6	
1961		2.6			6.7	
1962		2.8			5.5	
	High	Medium	Low	High	Medium	Low
1963	3.0	2.5	2.0	6.5	5.0	4.0
1964	3.0	2.5	2.0	6.5	5.0	4.0
1965	3.0	2.5	2.0	6.5	5.0	4.0
1966	3.0	2.4	2.0	6.5	5.0	4.0
1967	3.0	2.4	2.0	6.5	5.0	4.0
1968	3.0	2.4	2.0	6.5	5.0	4.0
1969	3.0	2.3	2.0	6.5	5.0	4.0
1970	3.0	2.3	2.0	6.5	5.0	4.0
1971	3.0	2.3	2.0	6.5	5.0	4.0

SOURCE: 1950-1962 data from *1961 Statistical Abstract of the United States* and *Survey of Current Business*, August, 1962; Series I (high) and III (low) population projections from *Current Population Reports*, Series P-25, No. 187, Nov. 10, 1958, Bureau of the Census; Series II (medium) from *Financing Education in the 1960's*, Special Project of School Finance, Research Division, National Education Association.

bers of the labor force for the next 15 years have already been born. These estimates suggest that in the next decade more than 11 million people will be added to the total labor force and that the increase might be as high as 14 million. Moreover, assuming that the size of the military forces increases only slightly during the next ten years (in accordance with our basic assumptions), somewhere between 10 million and 14 million more civilians will be in the labor market ten years from now as compared with the current size of the civilian labor force.

The anticipated distribution of the U.S. population by age during the next ten years is shown in Table 3. As is apparent from that table, increases are expected in all age brackets, though the most pronounced increase is likely to take place in the number of teenagers. Thus, by 1971 the number of people aged 18 to 21 should reach 15 million, almost 50 percent above the figure for mid-1962. On the other hand, the proportion of people 65 and over in 1971 is expected to be only slightly higher than their proportion at the present time, about 9.4 percent. However, their number will have increased from 17.4 million currently to 20.5 million in 1971.

Prospects for Illinois

Production and income in the State of Illinois are not expected to grow as rapidly as in the rest of the nation. In part this is due to the fact that most other states have a lot more "catching-up" to do to attain the advanced standard of living in this state, and such catching-up is being facilitated by the increasing scope of the operations of the Federal Government and of its social welfare programs. In part also the anticipated slower rate of increase of Illinois reflects the fact that it is not experiencing the very rapid expansion taking place in some of the newer areas of the country, particularly the West Coast and the Southwest. Nevertheless, the level of economic activity in the state ten years from now should still be appreciably above the average for the rest of the nation.

In 1962, per capita income in Illinois (in 1961 dollars) is estimated at $2,758. This figure is roughly 18 percent above the average per capita income for 1962 in the nation as a whole. However, during the past decade the margin by which Illinois per capita income has exceeded that of the U.S. as a whole has been declining slightly, by roughly three-hundredths of one percent per year. For reasons mentioned previously, a continuation of this trend during the next decade would seem reasonable, and per capita incomes for Illinois have been extrapolated for the next ten years on the basis of this assumption.[1]

The results, shown in Column 2 of Table 4, suggest that Illinois per

[1] The actual formula is:

$$\frac{\text{Illinois per capita income, year t}}{\text{U.S. per capita income, year t}} = 118.07\% \; (.9997)^{t} \; (\text{U.S. per capita income})$$

The same formula was used to obtain high and low per capita income estimates for Illinois, using the appropriate series from Column 5 in Table 1.

TABLE 3
Estimated and Projected Population of United States by Age, 1950-1971
(Medium Projection)
(Millions)

Year	Total	Under 5	5-13	14-17	18-21	22-64	65 and Over	14 and Over	Percent 65 and Over	Percent 14 and Over
1950	151.9	16.2	22.3	8.4	9.0	83.7	12.3	113.2	8.1	74.5
1951	154.1	17.2	22.9	8.5	8.8	84.1	12.6	114.3	8.2	74.2
1952	156.5	17.2	24.5	8.7	8.6	84.5	13.0	115.4	8.3	73.7
1953	159.0	17.4	25.7	8.9	8.5	85.2	13.3	116.5	8.4	73.3
1954	161.9	17.8	27.0	9.0	8.5	85.9	13.7	117.6	8.5	72.6
1955	165.1	18.3	28.1	9.2	8.6	86.8	14.1	118.9	8.5	72.0
1956	168.0	18.7	29.2	9.5	8.8	87.4	14.4	120.3	8.6	71.6
1957	171.1	79.2	30.1	10.2	8.9	88.0	14.7	122.0	8.6	71.3
1958	174.1	19.5	31.1	10.6	9.1	88.8	15.0	123.4	8.6	70.9
1959	177.1	19.8	32.4	11.0	9.3	89.2	15.4	124.9	8.7	70.5
1960	180.7	20.3	33.1	11.1	9.6	89.9	16.7	127.3	9.2	70.4
1961	183.7	20.6	33.3	12.0	10.2	90.6	17.0	129.8	9.3	70.7
1962	186.6	21.0	34.1	12.5	10.4	91.2	17.4	131.5	9.3	70.5
1963	189.0	21.1	34.5	13.0	10.8	91.8	17.5	133.1	9.3	70.4
1964	192.5	21.4	35.1	13.7	11.3	92.8	17.8	135.6	9.2	70.4
1965	195.5	21.6	35.8	14.4	12.0	93.6	18.2	138.2	9.3	70.7
1966	198.0	22.2	36.2	14.7	12.4	95.0	18.5	140.6	9.3	71.0
1967	202.5	22.8	36.8	15.0	12.8	97.0	18.9	143.7	9.3	71.0
1968	206.5	23.4	37.2	15.3	13.3	98.5	19.3	146.4	9.3	70.9
1969	210.0	24.0	37.8	15.6	13.8	100.0	19.7	149.1	9.4	71.0
1970	213.5	24.6	38.3	15.9	14.4	100.2	20.0	150.5	9.4	70.5
1971	217.0	25.3	38.8	16.3	15.0	100.5	20.5	152.3	9.4	70.2

SOURCE: 1950-1962 data from *Current Population Reports*, Series P-25, Bureau of the Census. Projections from *Financing Education in the 1960's*, Special Project on School Finance, Resea:ch Division, National Education Association.

TABLE 4
Estimated and Projected Income and Population of Illinois, 1950-1971

(1) Year	(2) Per Capita Income 1961 Prices (Dollars)			(3) Population (Thousands)			(4) Personal Income 1961 Prices (Billions)		
1950	2,290			8,712			20.0		
1951	2,394			8,752			20.9		
1952	2,414			8,840			21.3		
1953	2,514			2,988			22.6		
1954	2,456			9,134			22.4		
1955	2,546			9,237			23.5		
1956	2,675			9,425			25.2		
1957	2,666			9,647			25.7		
1958	2,558			9,949			25.4		
1959	2,656			9,974			26.5		
1960	2,663			10,081			26.8		
1961	2,676			10,260			27.4		
	High	Medium	Low	Series I	Series II	Series III	High	Medium	Low
1962	2,775	2,758	2,746	10,687	10,450	10,431	29.0	28.8	28.7
1963	2,845	2,824	2,811	10,887	10,700	10,659	30.4	30.2	30.1
1964	2,925	2,883	2,856	11,058	10,850	10,830	31.7	31.3	31.0
1965	3,016	2,952	2,909	11,343	10,977	11,035	33.1	32.4	31.9
1966	3,118	3,030	2,972	11,571	11,300	11,172	35.2	34.2	33.6
1967	3,193	3,080	3,007	11,799	11,500	11,286	36.7	35.4	34.5
1968	3,279	3,140	3,051	12,027	11,750	11,514	38.5	36.9	35.8
1969	3,377	3,211	3,104	12,255	11,900	11,685	40.2	38.2	36.9
1970	3,478	3,283	3,159	12,512	12,047	11,867	41.9	39.5	38.1
1971	3,583	3,359	3,216	12,768	12,400	12,084	44.4	41.6	39.9

SOURCE: 1950-1961 data from *1961 Statistical Abstract of the United States and Survey of Current Business*, August, 1962; Series II (medium) population projections from *Financing Education in the 1960's*, Special Project on School Finance, Research Division, National Education Association. Series I (high) and III (low) were derived by obtaining the Illinois share of population times Series I and III figures on Table 2. Per capita income was obtained by multiplying projected U.S. per capita income by the Illinois projected share of per capita income, e.g., in 1962 Illinois per capita income will be 118.03% of U.S. per capita income.

capita incomes by 1971 should be about 22 percent above the 1962 level, and might well exceed the current level by as much as 30 percent. The increase in total Illinois income will be much more than that because the population of the state is expected to grow also. Population projections, shown in Column 3 of Table 4, indicate an increase of 19 percent over the next decade, the increase possibly being as high as 22 percent. The combination of these two factors, shown in Column 4 of Table 4, suggests that the total personal income of the people of Illinois, in 1961 prices, will rise from $28.8 billion in 1962 to somewhere between $40 billion and $44 billion in 1971. The most likely figure would seem to be $41.6 billion, or 52 percent more than the 1962 level. Under favorable conditions the increase could be as high as 62 percent, while under less favorable conditions the increase might not be much more than 45 percent. In any event, substantial growth of the Illinois economy is in prospect.

The anticipated distribution of the future population of Illinois by age groupings is shown in Table 5 and illustrated in Chart 1. As in the case for the country as a whole, the number of people in the state in each of the age groups shown is expected to increase during the next decade. Once more, however, the largest increase is expected in the number of teenagers, those between the ages of 18 and 21 rising from 510,000 in 1961 to almost 800,000 ten years later. At the same time, those aged 14 to 17 will increase from 610,000 in 1961 to almost 900,000 in 1971. At the other end of the scale, the number of people aged 65 and over is expected to increase from 990,000 in 1961 to 1,175,000 in 1971. However, the latter rate of increase is somewhat less than that anticipated for the population as a whole, so the number of senior citizens as a proportion of the total is expected to decline slightly, to 9.5 percent in 1971.

Sources of Income

The income of Illinois people in future years will come increasingly from earnings in manufacturing, trade, finance, and service activities. These and other projections of expected sources of income are shown in Table 6, and are portrayed graphically in Chart 2. In relative terms, the largest increases are expected to occur in other labor income and in transfer payments (primarily social security), with the latter partly offset by higher personal contributions for social insurance. In absolute terms, earnings from wages and salaries are, and will continue to be, the major source of personal income, accounting for roughly two-thirds of Illinois personal income. Since 1950, wage and salary disbursements have ranged from a low of 67.8 percent of the total in 1950 to a high of 71.8 percent in 1956. Although this percentage has remained relatively stable over time, this is not true of those sources that make up wage and salary disbursements, as is evident from Chart 3 and the following tabulation:

Source	1950	1961
Agriculture	.56%	.35%
Mining	1.07	.55
Contract construction	3.45	4.13
Manufacturing	26.55	24.61
Wholesale and retail trade	13.13	13.21
Finance, insurance, and real estate	2.93	3.59
Transportation	5.01	4.11
Communications and public utilities	1.96	1.97
Services	6.17	7.28
Government	6.86	8.46
Other industries	.06	.09
Total wages and salary disbursements	67.75	68.35
Total personal income	100.00%	100.00%

As expected, since 1950 agricultural wages have declined relative to state personal income. This is due largely to the exodus of population from the rural areas to the metropolitan areas and to the increasing mechanization of Illinois farms. Mining is similar to agriculture in that great application of machinery, as in strip mining, has contributed to the reduction in the labor force. This trend coupled with an overall reduction in mining activity in Illinois accounts for the decline in importance of wages from the mining industry.

Wages and salaries received from the construction industry are expected to remain at approximately 4 percent of personal income. Other wage and salary sources that are expected to remain relatively stable in the next decade are wholesale and retail trade at 13.1 percent and communications and public utilities at 2.0 percent.

Manufacturing is expected to continue as the mainstay of the Illinois economy, though in the next decade the relative importance of wages and salaries to personal income may decline slightly. This decline, about one percent per year, may be due to such factors as increased automation and the tendency to establish new operations in the southern and western states. Nevertheless, wages and salaries from manufacturing are expected to increase from a 1961 figure of $6.7 billion to somewhere between $8.9 billion and $9.9 billion in 1971. The medium estimate, $9.3 billion, represents an increase of 37 percent over 1961.

With the increasing population and the rising standard of living, financial, insurance and real estate transactions may be expected to increase sharply. With Chicago as a center for such activities, wages and salaries paid by this industry will contribute a growing share to Illinois incomes.

TABLE 5
Estimated and Projected Population of Illinois by Age, 1950-1971
(Medium Projection)
(Thousands)

Year	Total	Under 5	5-13	14-17	18-21	22-64	65 and Over	14 and Over	Percent 65 and Over	Percent 14 and Over
1950	8,712	843	1,141	424	366	5,184	754	6,728	8.7	77.2
1951	8,752	906	1,154	454	326	5,131	781	6,692	8.9	76.5
1952	8,840	905	1,215	459	300	5,157	804	6,720	9.1	76.0
1953	8,988	926	1,280	553	234	5,164	831	6,782	9.2	75.5
1954	9,134	947	1,411	475	287	5,160	854	6,776	9.3	74.2
1955	9,237	970	1,464	471	294	5,176	862	6,803	9.3	73.6
1956	9,425	1,001	1,541	490	300	5,212	882	6,884	9.4	73.0
1957	9,647	1,039	1,602	532	310	5,260	904	7,006	9.4	72.6
1958	9,949	1,070	1,679	567	342	5,376	914	7,199	9.3	73.0
1959	9,974	1,107	1,662	571	405	5,274	955	7,205	9.6	72.2
1960	10,081	1,130	1,732	576	482	5,185	976	7,219	9.7	71.6
1961	10,260	1,150	1,780	610	510	5,220	990	7,330	9.6	71.4
1962	10,450	1,175	1,810	642	539	5,250	1,005	7,465	9.6	71.4
1963	10,700	1,210	1,845	680	568	5,290	1,020	7,645	9.5	71.4
1964	10,850	1,245	1,880	720	595	5,310	1,040	7,725	9.6	71.4
1965	10,977	1,252	1,936	758	628	5,339	1.064	7,789	9.7	71.0
1966	11,300	1,320	1,960	780	655	5,410	1,075	8,020	9.5	71.0
1967	11,500	1,350	2,000	800	680	5,480	1,095	8,150	9.5	70.9
1968	11,750	1,395	2,050	823	710	5,520	1,120	8,305	9.5	70.7
1969	11,900	1,440	2,090	845	739	5,600	1,140	8,370	9.6	70.3
1970	12,047	1,480	2,127	859	763	5,653	1,166	8,440	9.7	70.1
1971	12,400	1,510	2,180	888	798	5,720	1,175	8,710	9.5	70.2

SOURCE: 1950-1961 data from *Current Population Reports*, Series P-25, Bureau of the Census; 1962-1971 projections from *Financing Education in the 1960's*, Special Project on School Finance, Research Division, National Education Association.

CHART 1

Population by Age in 1971 as a Percent of 1961

(Medium Projection)

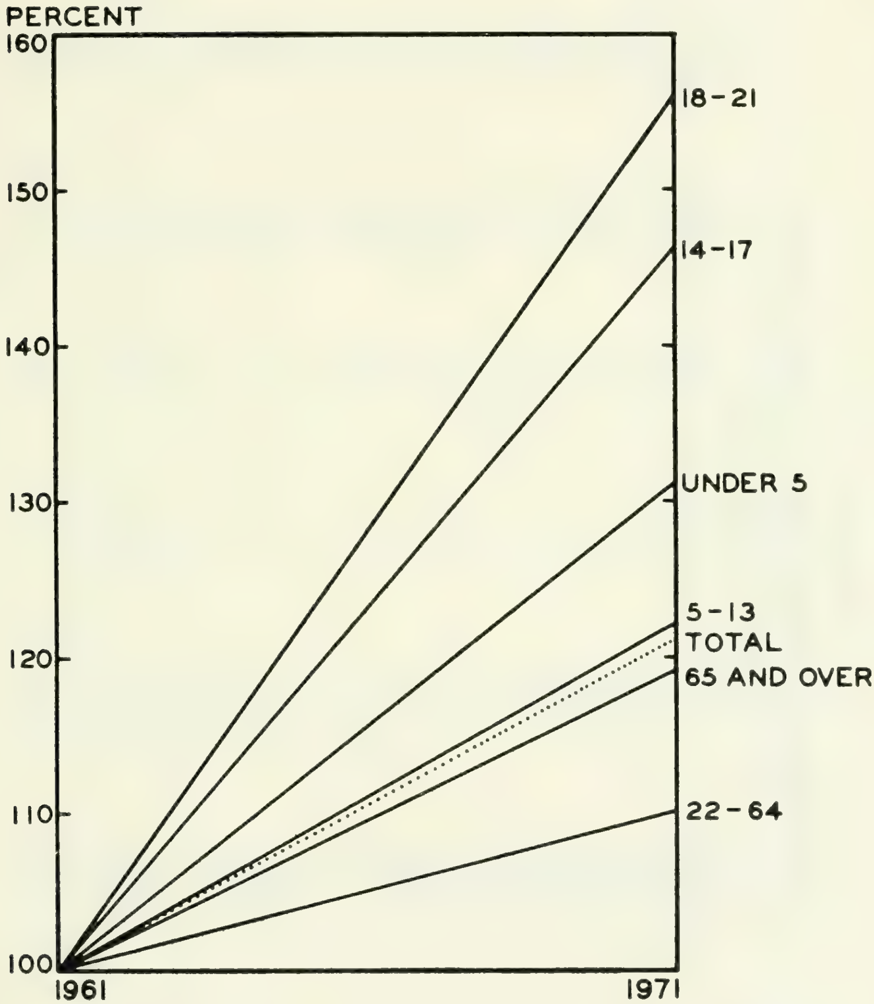


TABLE 6

Estimated and Projected Illinois Personal Income by Source of Income, 1950-1971
(In Millions of 1961 Dollars)

Year	Total Personal Income	Wages and Salaries					
		Total	Agriculture	Mining	Construction	Manufacturing	Trade
1950	20,000	13,554	112	214	690	5,310	2,626
1951	20,900	14,486	113	205	803	5,758	2,702
1952	21,300	15,013	103	186	852	6,039	2,745
1953	22,600	15,991	94	178	932	6,649	2,878
1954	22,400	15,685	94	161	912	6,226	2,985
1955	23,500	16,647	94	169	966	6,660	3,067
1956	25,200	18,022	90	178	1,135	7,196	3,328
1957	25,700	18,233	92	173	1,130	7,202	3,384
1958	25,400	17,434	95	163	1,102	6,480	3,301
1959	26,500	18,481	90	167	1,137	6,980	3,498
1960	26,800	18,781	91	155	1,147	6,885	3,607
1961	27,400	18,725	96	151	1,132	6,743	3,620
				Medium			
1962	28,800	19,648	98	150	1,195	7,016	3,776
1963	30,200	20,580	97	148	1,253	7,281	3,959
1964	31,300	21,314	97	147	1,329	7,418	4,103
1965	32,400	22,038	97	143	1,345	7,653	4,248
1966	34,200	23,252	96	144	1,419	7,996	4,484
1967	35,400	24,002	96	142	1,469	8,192	4,641
1968	36,900	25,066	96	140	1,531	8,450	4,838
1969	38,200	25,943	95	138	1,585	8,660	5,008
1970	39,500	26,823	95	134	1,639	8,864	5,178
1971	41,600	28,254	96	133	1,726	9,239	5,454

TABLE 6 (Continued)

Year	Total Personal Income	Wages and Salaries					
		Total	Agriculture	Mining	Construction	Manufacturing	Trade
				Low			
1962	28,700	19,580	98	149	1,191	6,991	3,763
1963	30,100	20,513	96	147	1,249	7,257	3,946
1964	31,000	21,112	96	146	1,318	7,347	4,064
1965	31,900	21,698	96	140	1,324	7,535	4,182
1966	33,600	22,845	94	141	1,394	7,856	4,405
1967	34,600	23,459	93	138	1,436	8,006	4,536
1968	35,800	24,318	93	136	1,486	8,198	4,693
1969	36,900	25,059	92	133	1,531	8,365	4,838
1970	38,100	25,874	91	130	1,581	8,550	4,995
1971	39,900	27,100	92	128	1,656	8,862	5,231
				High			
1962	29,000	19,785	99	151	1,204	7,064	3,802
1963	30,400	20,717	97	149	1,262	7,329	3,985
1964	31,700	21,587	98	149	1,347	7,513	4,156
1965	33,100	22,515	99	146	1,374	7,818	4,339
1966	35,200	23,932	99	148	1,461	8,230	4,615
1967	36,700	24,883	99	147	1,523	8,492	4,811
1968	38,500	26,153	100	146	1,598	8,817	5,047
1969	40,200	27,298	100	145	1,667	9,113	5,270
1970	41,900	28,454	101	142	1,739	9,402	5,493
1971	44,400	30,156	102	142	1,843	9,860	5,821

SOURCE: 1950-1961 data from *Personal Income by States* and *Survey of Current Business.*

TABLE 6 (Continued)

Year	Wages and Salaries					
	Finance, Insurance, and Real Estate	Transportation	Communications and Public Utilities	Services	Government	Other Industries
1950	586	1,002	392	1,234	1,372	12
1951	600	1,066	395	1,252	1,570	15
1952	631	1,083	419	1,297	1,680	15
1953	670	1,098	457	1,379	1,636	18
1954	720	1,039	471	1,423	1,728	18
1955	768	1,093	491	1,535	1,786	19
1956	808	1,177	522	1,677	1,890	20
1957	847	1,183	530	1,719	1,948	26
1958	853	1,104	515	1,744	2,051	25
1959	888	1,179	533	1,834	2,152	24
1960	933	1,177	539	1,935	2,289	24
1961	984	1,126	540	1,995	2,318	25
			Medium			
1962	1,054	1,161	582	2,134	2,456	26
1963	1,129	1,193	610	2,277	2,606	27
1964	1,166	1,211	632	2,401	2,779	31
1965	1,260	1,228	654	2,527	2,851	32
1966	1,358	1,272	691	2,715	3,040	34
1967	1,437	1,292	715	2,800	3,179	35
1968	1,528	1,317	745	3,033	3,347	41
1969	1,612	1,337	772	3,194	3,499	42
1970	1,702	1,355	798	3,361	3,654	43
1971	1,830	1,402	840	3,603	3,885	46

TABLE 6 (Continued)

Year	Wages and Salaries					
	Finance, Insurance, and Real Estate	Transportation	Communications and Public Utilities	Services	Government	Other Industries
			Low			
1962	1,050	1,157	580	2,127	2,448	26
1963	1,126	1,189	608	2,270	2,598	27
1964	1,153	1,200	626	2,378	2,753	31
1965	1,241	1,209	644	2,488	2,807	32
1966	1,334	1,250	679	2,668	2,987	34
1967	1,405	1,263	699	2,737	3,107	35
1968	1,482	1,278	723	2,943	3,247	39
1969	1,557	1,292	745	3,085	3,380	41
1970	1,642	1,307	770	3,242	3,524	42
1971	1,753	1,345	806	3,455	3,727	44
			High			
1962	1,061	1,169	586	2,149	2,474	26
1963	1,137	1,201	614	2,292	2,624	27
1964	1,179	1,227	640	2,431	2,815	32
1965	1.288	1,254	669	2,582	2,913	33
1966	1.397	1,309	711	2,795	3,129	35
1967	1,490	1,340	741	2,903	3,296	37
1968	1,594	1,374	778	3.165	3,492	42
1969	1.696	1,407	811	3,361	3,682	44
1970	1,806	1,437	846	3,566	3,876	46
1971	1,954	1,496	897	3,845	4,147	49

TABLE 6 (Continued)

Year	Other Labor Income	Proprietor's Income: Total	Proprietor's Income: Farm	Proprietor's Income: Business and Professional	Property Income	Transfer Payments	Less: Personal Contributions for Social Insurance
1950	360	2,760	884	1,876	2,552	1,006	232
1951	422	2,951	1,051	1,902	2,462	830	247
1952	453	2,859	946	1,915	2,435	809	270
1953	506	2,732	826	1,906	2,644	1,007	277
1954	515	2,694	827	1,864	2,785	1,048	328
1955	557	2,634	696	1,939	2,909	1,114	362
1956	595	2,824	833	1,990	2,964	1,162	407
1957	683	2,907	747	2,157	2,985	1,298	454
1958	678	2,944	818	2,126	3,122	1,591	449
1959	734	2,806	594	2,213	3,318	1,680	522
1960	766	2,785	547	2,238	3,312	1,763	608
1961	781	2,932	808	2,124	3,540	2,039	606
				Medium			
1962	847	3,009	809	2,200	3,583	2,393	685
1963	938	3,100	809	2,291	3,775	2,571	764
1964	983	3,118	798	2,320	3,900	2,824	839
1965	1,000	3,152	787	2,365	3,987	3,173	950
1966	1,142	3,249	790	2,459	4,200	3,386	1,029
1967	1,221	3,289	779	2,510	4,361	3,710	1,183
1968	1,267	3,351	775	2,576	4,507	3,956	1,247
1969	1,406	3,392	764	2,628	4,710	4,120	1,371
1970	1,501	3,428	750	2,678	4,922	4,327	1,501
1971	1,631	3,532	753	2,779	5,183	4,675	1,676

TABLE 6 (Continued)

Year	Other Labor Income	Proprietor's Income			Property Income	Transfer Payments	Less: Personal Contributions for Social Insurance
		Total	Farm	Business and Professional			
				Low			
1962	845	3,000	806	2,194	3,571	2,386	682
1963	936	3,088	807	2,281	3,763	2,562	762
1964	973	3,088	790	2,298	3,863	2,796	832
1965	986	3,104	774	2,329	3,927	3,123	938
1966	1,122	3,192	776	2,416	4,126	3,326	1,011
1967	1,194	3,214	761	2,453	4,263	3,626	1,156
1968	1,229	3,252	752	2,500	4,372	3,838	1,209
1969	1,358	3,277	738	2,539	4,550	3,982	1,326
1970	1,448	3,307	724	2,583	4,747	4,172	1,448
1971	1,564	3,388	722	2,666	4,972	4,485	1,608
				High			
1962	854	3,031	815	2,216	3,609	2,411	690
1963	946	3,119	815	2,304	3,800	2,587	769
1964	995	3,158	808	2,350	3,950	2,860	850
1965	1,023	3,221	804	2,417	4,075	3,240	974
1966	1,176	3,344	813	2,531	4,323	3,485	1,060
1967	1,266	3,409	807	2,602	4,521	3,847	1,226
1968	1,322	3,496	808	2,688	4,702	4,128	1,301
1969	1,480	3,570	804	2,766	4,957	4,338	1,443
1970	1,592	3,637	796	2,841	5,221	4,588	1,592
1971	1,740	3,770	804	2,966	5,532	4,991	1,789

SOURCE: 1950-1961 data from *Personal Income by States* and *Survey of Current Business.*

CHART 2

Sources of Personal Income for Illinois, 1950, 1961, 1971

(In Millions of 1961 Dollars)

(Medium Projection)

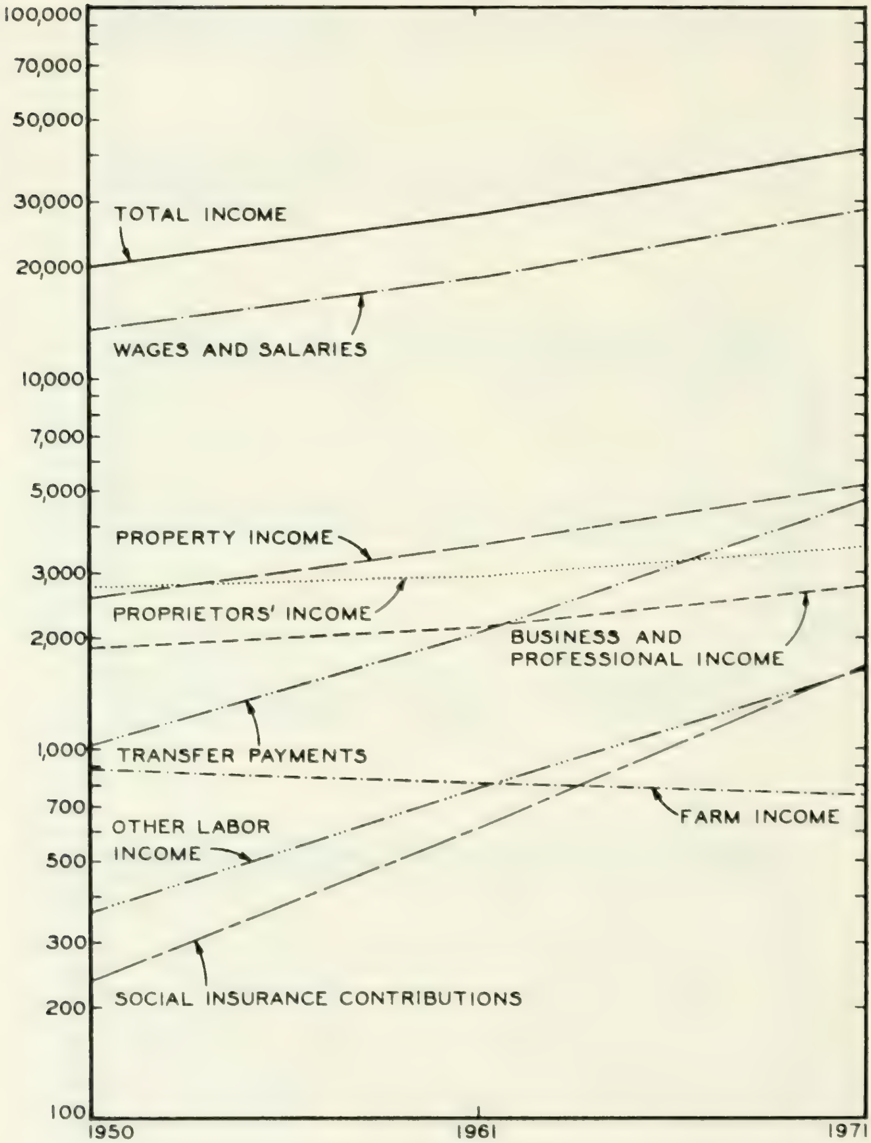
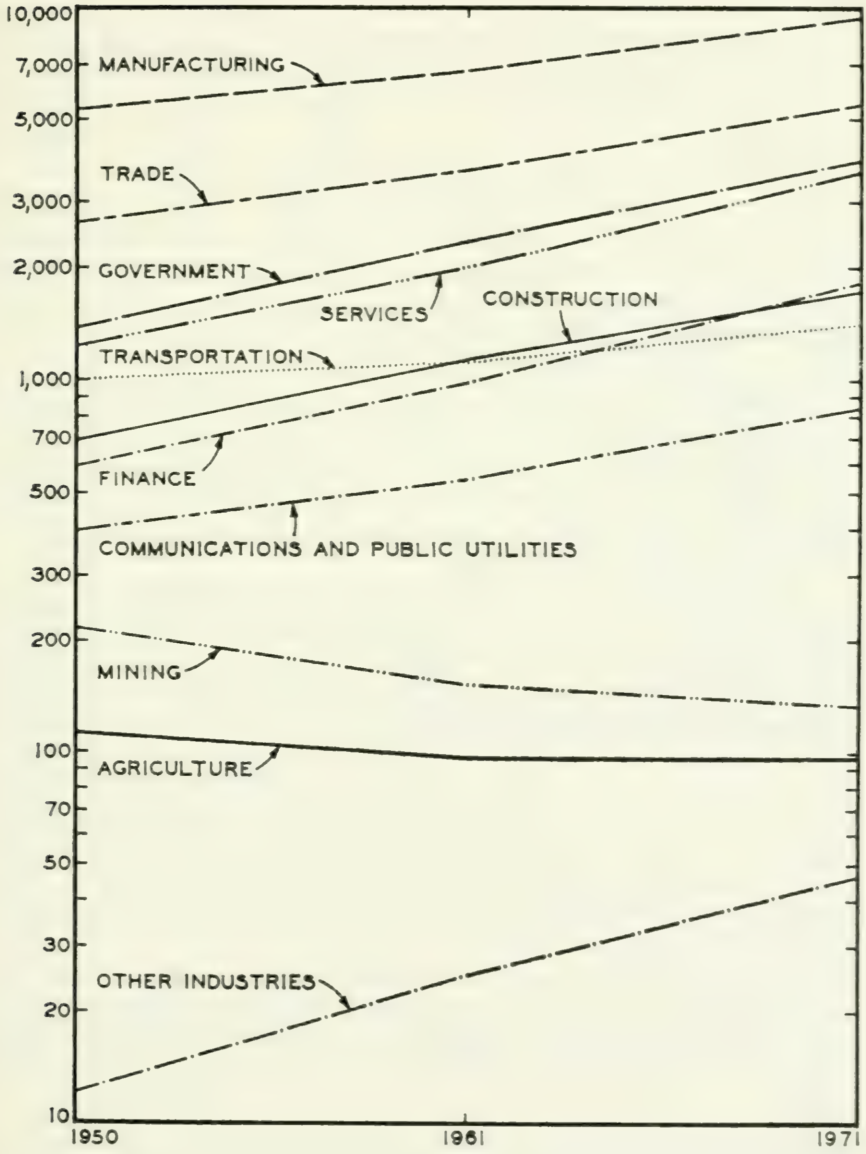


CHART 3

Sources of Wage and Salary Disbursements, 1950, 1961, 1971

(In Millions of 1961 Dollars)

(Medium Projection)



According to the medium estimate, total earnings from this industry will be $1.8 billion in 1971 compared to barely $1.0 billion in 1961, an increase of 86 percent.

Wages and salaries earned in transportation have declined in importance relative to total personal income for many years. This decline represents primarily the declining share of business obtained by the railroads, as illustrated by the following employment data (in thousands).[2]

Employment in:	1950	1960	1961
All transportation	293.6	284.5	274.1
Railroads	131.8	106.0	100.2
Transportation other than railroads	161.8	178.5	173.9

Although this decline will continue for some time yet, it is likely to be offset by the growing volume of business of other forms of transportation, particularly air transportation. Hence, earnings from this industry are expected to rise in the next decade appreciably more than in the last, by 25 percent to about $1.4 billion in 1971.

Historically, as a nation prospers its consumption of services increases. The same may be expected of Illinois during the next decade, so that wages and salaries from the service industries in 1971 are projected to be 81 percent higher than 1961. These earnings will be primarily from accelerated activity in hotels, personal services (laundry, dry cleaning, etc.), business services, auto repair and amusements.

Another source of wages and salaries that will continue to increase more rapidly than most others is the government sector. Government wages and salaries include not only those paid by the federal government but those paid by the state, county, township, and city governments as well. Increasing population necessitates more government participation in numerous ways—more teachers, increased fire and police protection, more road construction, more people to operate the various governments, not to mention the gradual expansion in the scope of governmental activities. The relative importance of wages and salaries derived from governments rose from 6.9 percent in 1950 to 8.5 percent in 1961. Government wages and salaries, which totaled $2.3 billion in 1961, are expected to rise to between $3.7 billion and $4.1 billion in 1971.

The projected increase in other labor income is 109 percent. This category includes workmen's compensation, employers' contributions to private welfare funds, and pay to military reservists. Income from this source amounted to $781 million in 1961 and is projected to be about $1.6 billion in 1971.

[2] *Employment, Hours, and Earnings in Illinois,* No. VII, Part I, Revised Employment Data 1958-1961, State of Illinois, Department of Labor, March, 1962.

Income from sources other than wages and salaries is expected to follow mixed trends. Total proprietors' income declined from 13.8 percent of Illinois personal income in 1950 to 10.7 percent in 1961, mainly because of the decline in farmers' income from 4.4 percent in 1950 to 2.9 percent in 1961. This decline in farm proprietors' income is projected to continue. Farm income averaged $692 million in the last four years and is forecast at $753 million in 1971, an increase of only 9 percent. On the other hand, business and professional proprietors will earn 31 percent more in 1971 than they did in 1961. However, the relative importance of this source of income, down from 9.4 percent in 1950 to 7.7 percent in 1961, will continue to decline, largely because of the more rapid growth of large business enterprises.

The importance of property income to Illinois personal income is expected to remain at approximately 12.4 percent for the next decade, the same as in the past decade. Property income of $5.2 billion in 1971 will be about 46 percent above the 1961 figure of $3.5 billion.

The largest increases of all may be expected in transfer payments and in personal contributions for social insurance. In 1971 transfer payments as a source of personal income should be roughly 129 percent greater than in 1961, principally because of the growing number of people receiving old age and retirement benefits. For similar reasons, as Illinois personal income increases, personal contributions for social insurance will also increase. The amount involved, estimated at $1.7 billion in 1971, will offset about half the increase in transfer payments while rising 177 percent over the 1961 figure.

All things considered, personal income in Illinois should be about 52 percent greater in 1971 than in 1961, at 1961 prices. (To the extent that prices rise, incomes should be correspondingly higher). While the relative importance of the economy of Illinois to the United States will probably continue to decline slightly, since Illinois is so closely linked to the rest of the United States, it is safe to say that as long as the economy of the nation grows Illinois will prosper.

Area Projections

Prediction of local economic developments is especially hazardous. Not only are such predictions subject to the same limitations as any other predictions, but as a rule little is known about the current or past trends in the local areas with any reliability. Indeed, data for local areas are among the least reliable economic series. For these reasons, the projections in this section must be treated with special care, and should be interpreted as rough approximations to the future trend of economic activity in the different parts of the state.

For the present purposes, projections of economic activity have been prepared for each of the metropolitan areas of the state and for the com-

bined metropolitan areas.[3] These breakdowns appear to be meaningful from an economic point of view and are also the areas for which the most data are currently available.

The past and projected populations of each of the state's metropolitan areas and of the nonmetropolitan segment are shown in Table 7. As is evident from this table, more than three-quarters of the population of the state currently reside in one of the metropolitan areas. This shift toward urban centers is expected to continue during the next ten years, with the result that by 1971 these areas will contain over 80 percent of the state's population. Indeed, the percent increase during the next ten years in the population of these metropolitan areas is expected to be twice as high as the increase during the 1950's, as is shown in Chart 4. At the same time, the number of people in the nonmetropolitan areas will increase somewhat also, but the rate of increase is expected to fluctuate about the 1961 level of 2.3 million, the product of a declining percentage and an increasing total population.

All metropolitan areas of the state are expected to experience substantially more population increases than the nonmetropolitan areas. However, the rate of increase is likely to vary substantially among areas, as may be seen from Chart 4. The largest increase is expected in the Rockford Metropolitan Area, as the scope of industrial activity continues to widen. In addition, substantial increases in population—increases of more than 25 percent—are expected to occur in the Chicago area, in Champaign-Urbana, and in the East St. Louis area.

Increases in per capita income do not always accompany increases in population. This fact is illustrated by the data in Table 8 and in Chart 5, which show that the expected changes in per capita income in the different parts of the state are much more uniform than the expected changes in the population. These estimates are based on projections of trends during the past decade in per capita incomes by these local areas. In contrast to expected population trends, the nonmetropolitan areas are expected to experience a larger increase in per capita income than the metropolitan areas. In part this is due to the anticipated dispersion of industrial activities as well as to the increasing mechanization and higher levels of income in agriculture. In part also, however, this greater increase reflects the much lower current levels of per capita income in the rural areas.

Despite these differences in the anticipated rates of increase by area, the per capita income of the metropolitan areas by 1971 is expected to remain considerably above that of the nonmetropolitan areas. At $3,604, the per capita income of the former would be more than half as large as the per capita income of the rural areas in 1971.

---

[3] A metropolitan area, as defined by the U. S. Bureau of the Census, is an urban area containing a large central city and with at least 100,000 people residing in the boundaries of the area. At present, there are eight such areas in the state of Illinois.

TABLE 7
Estimated and Projected Illinois Population by Area, 1950-1971, Medium Projection
(Thousands)

Year	State Total	Metropolitan Areas									Non-metropolitan
		Total	Chicago	Champaign	Decatur	East St. Louis	Peoria	Rockford	Rock Island	Springfield	
1950	8,712	6,439	5,178	106	99	388	251	152	134	131	2,273
1951	8,752	6,577	5,287	109	101	399	255	158	135	133	2,230
1952	8,840	6,610	5,295	111	103	407	258	164	137	135	2,232
1953	8,988	6,700	5,360	114	105	416	262	169	138	136	2,256
1954	9,134	6,805	5,441	116	106	425	265	174	140	138	2,284
1955	9,237	7,009	5,620	118	108	434	269	180	141	139	2,240
1956	9,425	7,152	5,735	121	110	444	273	186	143	140	2,238
1957	9,647	7,336	5,894	124	112	453	276	191	144	142	2,285
1958	9,949	7,521	6,051	126	114	463	280	198	146	143	2,395
1959	9,974	7,618	6,120	129	116	473	284	204	147	145	2,325
1960	10,081	7,743	6,217	132	118	483	288	210	149	146	2,333
1961	10,260	7,918	6,363	135	120	493	293	216	151	147	2,336
1962	10,450	8,097	6,504	139	123	503	298	222	156	152	2,341
1963	10,700	8,337	6,710	143	126	513	305	228	158	154	2,357
1964	10,850	8,498	6,841	147	128	523	308	234	161	156	2,350
1965	10,977	8,651	6,963	151	131	533	312	240	163	158	2,337
1966	11,300	8,929	7,204	155	134	543	320	246	165	162	2,364
1967	11,500	9,112	7,354	159	137	553	325	252	168	164	2,363
1968	11,750	9,329	7,532	163	140	563	333	258	172	168	2,371
1969	11,900	9,537	7,710	167	143	573	336	264	174	170	2,357
1970	12,047	9,745	7,888	171	145	583	340	270	176	172	2,342
1971	12,400	9,974	8,075	175	149	593	350	276	180	176	2,370

SOURCE: 1950-1961 data from *Health Statistics Bulletin*, State of Illinois, Special Release No. 46, October, 1960.

CHART 4

Change in Population by Area, 1950-1961 and 1961-1971

(Medium Projection)

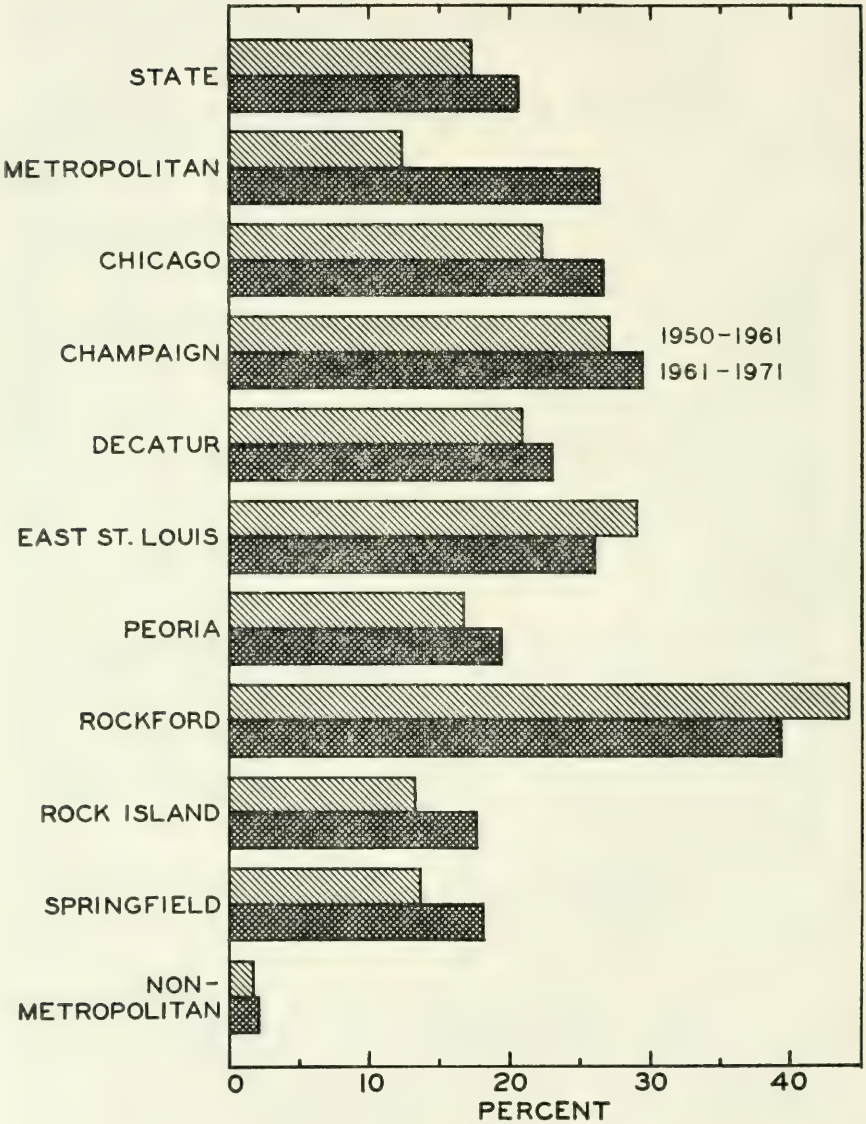


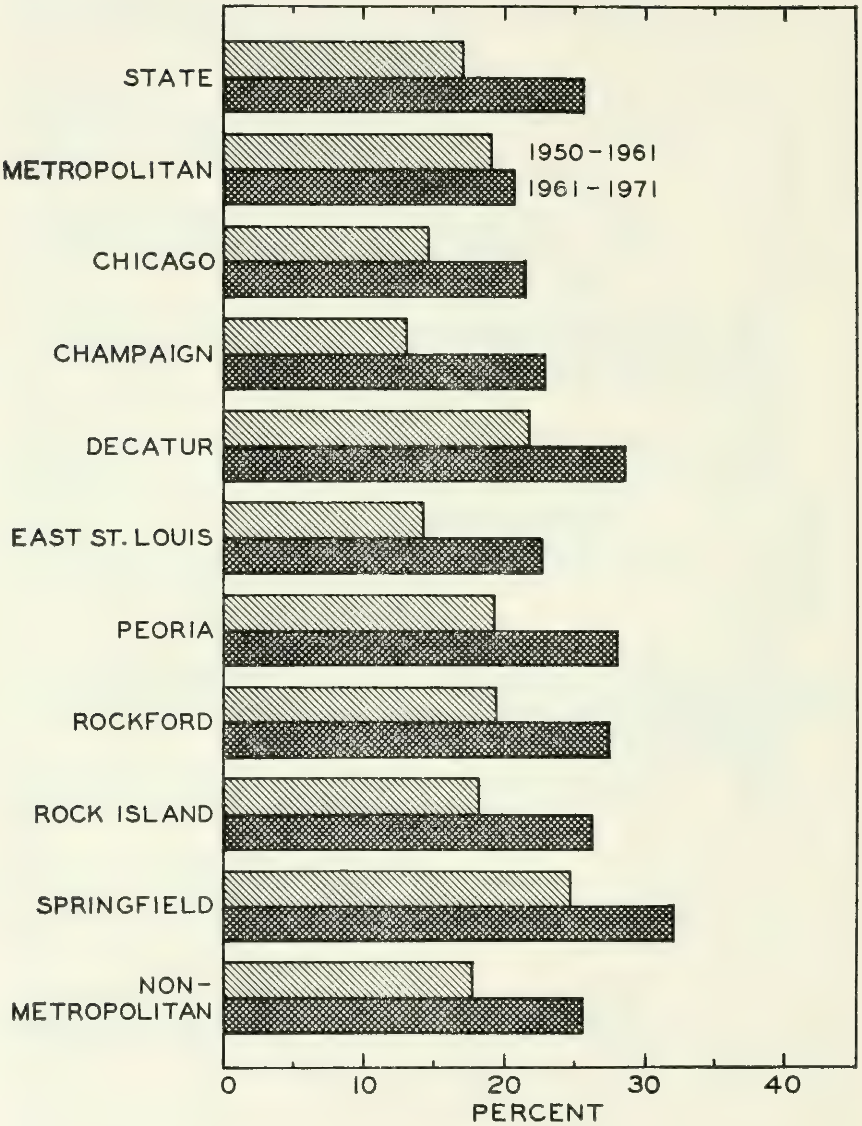
TABLE 8
Estimated and Projected Per Capita Income by Area, 1950-1971 Medium Projection, in 1961 Dollars

		Metropolitan Areas									
Year	State	All Metropolitan	Chicago	Champaign	Decatur	East St. Louis	Peoria	Rockford	Rock Island	Springfield	Non-metropolitan
1950	2,290	2,514	2,661	2,192	1,924	1,876	2,082	2,218	2,230	1,885	1,547
1951	2,394	2,631	2,786	2,286	2,020	1,958	2,177	2,334	2,338	1,972	1,614
1952	2,414	2,656	2,825	2,296	2,052	1,972	2,196	2,370	2,366	1,991	1,605
1953	2,514	2,773	2,945	2,363	2,168	2,049	2,286	2,489	2,469	2,076	1,647
1954	2,456	2,718	2,885	2,296	2,129	1,994	2,234	2,447	2,419	2,030	1,620
1955	2,546	2,794	2,970	2,368	2,253	2,037	2,310	2,609	2,431	2,164	1,667
1956	2,675	2,923	3,095	2,477	2,424	2,152	2,424	2,802	2,471	2,333	1,778
1957	2,666	2,899	3,077	2,480	2,393	2,106	2,400	2,700	2,560	2,360	1,828
1958	2,558	2,763	2,945	2,427	2,283	2,008	2,285	2,514	2,533	2,282	1,766
1959	2,656	2,885	3,065	2,442	2,312	2,124	2,459	2,587	2,613	2,296	1,785
1960	2,663	2,886	3,057	2,473	2,323	2,133	2,480	2,625	2,620	2,322	1,795
1961	2,676	2,989	3,050	2,475	2,342	2,141	2,482	2,649	2,634	2,349	1,821
1962	2,758	2,984	3,142	2,544	2,422	2,204	2,565	2,758	2,717	2,435	1,865
1963	2,824	3,053	3,216	2,601	2,485	2,251	2,630	2,827	2,783	2,511	1,906
1964	2,883	3,114	3,275	2,649	2,541	2,292	2,686	2,888	2,843	2,595	1,948
1965	2,952	3,185	3,340	2,708	2,607	2,339	2,754	2,958	2,912	2,662	1,997
1966	3,030	3,266	3,424	2,772	2,682	2,394	2,836	3,038	2,991	2,736	2,054
1967	3,080	3,317	3,465	2,810	2,734	2,429	2,892	3,089	3,043	2,794	2,090
1968	3,140	3,379	3,517	2,859	2,793	2,473	2,955	3,151	3,104	2,861	2,132
1969	3,211	3,451	3,589	2,919	2,859	2,520	3,024	3,223	3,175	2,938	2,182
1970	3,283	3,526	3,661	2,979	2,928	2,571	3,099	3,296	3,249	3,017	2,232
1971	3,359	3,604	3,743	3,038	3,006	2,625	3,177	3,374	3,325	3,098	2,286

CHART 5

Change in Per Capita Income by Area, 1950-1961 and 1961-1971

(Medium Projection)



The area with the highest per capita income is expected to continue to be Chicago, where income may increase from $3,050 in 1961 to $3,743 ten years later. This expected increase of 21 percent is somewhat below the rate of increase in other areas, such as Decatur and Peoria, where the increases are expected to reach 28 percent, and Springfield, with an anticipated increase of 32 percent. However, since the per capita income in these other areas is currently much lower than in Chicago, their per capita income ten years from now will still be several hundred dollars less than in the Chicago area.

By multiplying the population data in Table 7 by the per capita income data in Table 8, projections are obtained of total personal income in each area. The results of these projections, shown in Table 9, suggest that the income of the state will continue to be more concentrated in the eight metropolitan areas. In 1950, these areas accounted for 82 percent of the total personal income. This percentage had risen to 85 percent by 1961, and is expected to increase to 87 percent by 1971. As one would expect, the bulk of this income is in the Chicago Metropolitan Area, which accounted for 69 percent of the total personal income of the state in 1950, 71 percent in 1961, and is expected to account for 73 percent of the total in 1971.

In percentage terms, however, the biggest increase is expected in the Rockford area where total personal income should rise by 63 percent in the next ten years. Other large anticipated increases during the next decade are in Champaign (59 percent), Decatur (58 percent), Springfield (56 percent), and East St. Louis (45 percent). By comparison, the expected increase in the total personal income of the residents of the nonmetropolitan areas in the next decade is 27 percent.

All things considered, the general picture is one of gradual shifts in income and population brought about by the increasing industrialization of the state. Areas which are expected to obtain the greatest industrial development are those which are also expected to prosper the most, both in terms of income and population. At the same time, certain spill-over effects may be anticipated, with the result that the increases in economic activity should be shared by the bulk of the state's population.

Two Qualifications

Two basic limitations must be kept in mind in interpreting the results of this study. First, the projections presented on the foregoing pages are designed to picture the long-run trends in the Illinois economy. They are not designed to predict cyclical fluctuations in economic activity. Hence, these projections do not represent predictions of the level of activity in any particular year. For since the projections are meant to portray long-run trends, actual business conditions in some years may be above the trend and in other years may be below the trend. It is only when these year-to-year fluctuations are averaged out that the results are comparable with the

TABLE 9
Estimated and Projected Illinois Personal Income by Area, 1950-1971, Medium Projection in Millions of 1961 Dollars

Year	State Total	Metropolitan Areas									Non-metropolitan
		Total	Chicago	Champaign	Decatur	East St. Louis	Peoria	Rockford	Rock Island	Springfield	
1950	20,000	16,335	13,779	232	190	728	523	337	299	247	3,516
1951	20,900	17,466	14,730	249	204	781	555	369	316	262	3,599
1952	21,300	17,776	14,958	255	211	803	567	389	324	269	3,582
1953	22,600	18,777	15,785	269	228	852	599	421	341	282	3,716
1954	22,400	18,662	15,688	266	224	847	592	426	339	280	3,700
1955	23,500	19,832	16,691	279	243	884	621	470	343	301	3,734
1956	25,200	21,135	17,750	300	267	955	662	521	353	327	3,979
1957	25,700	21,548	18,136	308	268	954	662	516	369	335	4,177
1958	25,400	21,096	17,820	306	260	930	640	498	370	326	4,230
1959	26,500	22,289	18,758	315	268	1,005	698	528	384	333	4,150
1960	26,800	22,629	19,005	326	274	1,030	714	551	390	339	4,188
1961	27,400	23,141	19,407	334	281	1,077	727	572	398	345	4,254
1962	28,800	24,367	20,436	354	298	1,109	764	612	424	370	4,366
1963	30,200	25,693	21,579	372	313	1,155	802	645	440	387	4,492
1964	31,300	26,683	22,404	389	325	1,199	827	676	458	405	4,578
1965	32,400	27,719	23,256	409	342	1,247	859	710	475	421	4,667
1966	34,200	29,347	24,666	430	359	1,300	908	747	494	443	4,856
1967	35,400	30,370	25,518	447	375	1,343	940	778	511	458	4,939
1968	36,900	31,664	26,603	466	391	1,392	984	813	534	481	5,055
1969	38,200	32,930	27,672	487	409	1,444	1,016	851	552	499	5,143
1970	39,500	34,346	28,878	509	425	1,499	1,054	890	572	519	5,227
1971	41,600	35,948	30,225	532	448	1,557	1,112	931	598	545	5,418

projections presented here. In all likelihood, these year-to-year variations in the business activity will fall within the low-high ranges presented for these projections. However, in one year business activity may be near the low for the long-range projection while in the other year business activity may be near the high for that projection. Forecasting cyclical or erratic variations in business activity on a long-range basis has not been the concern of this study.

Second, the projections are in terms of 1961 prices. To the extent that prices in future years deviate from the 1961 level, adjustment would be required in these projections. No doubt prices in future years will differ from those in 1961, most likely in an upward direction if the assumed conditions are fulfilled. The extent of this deviation is a matter of opinion, but the basic structure of the projection may well be unchanged within substantial variations of future prices. Hence, adjustments for price changes can be made using these projections as the basis. Thus, if it is anticipated that prices will rise at an average rate of 1 percent per year during the next decade, the projections for 1962 can be increased by a multiplicative factor of 1.01 for 1963, by $(1.01)^2$ for 1964, and so on. In this way, the projections can be modified to take into account any set of price changes that one may want to postulate.

All this is not to say that the projections in 1961 prices may not be subject to considerable margins of error. If the political-international assumptions on which the forecasts rest are invalid, the forecasts are hardly likely to be usable. Even within the framework of these assumptions, shifts in basic trends could bring about substantial discrepancies between these projections and what actually happens. Nevertheless, these forecasts would seem to portray at the present time the most likely course of future economic activity and therefore should prove useful for long-range planning.

CHAPTER II
PUBLIC ASSISTANCE EXPENDITURE
By Glenn W. Fisher*

Public assistance expenditure has risen rapidly in the last several months. This has naturally focused attention on the present and future role of this type of expenditure in the Illinois state financial picture.

In this chapter the public assistance programs are described and analyzed in an attempt to obtain some guidance as to the likely magnitude of future expenditures. The first step in making such an analysis is to study past trends in an effort to find out what factors have determined public assistance expenditures in the past. The ideal outcome of such an analysis would be the discovery of an exact mathematical relationship between expenditures and a few simple variables which are easy to project into the future. Unfortunately, such an ideal result has not been achieved. Instead it has become clear that the level of public assistance expenditure is determined by a very complex set of social, economic, demographic and political factors. Even to list all of these would be a formidable task. Determining the exact relative importance of each is impossible because of lack of adequate statistical data and the lack of a theoretical model which would make it possible to take account of the many complex interrelations.

It is possible, however, to discover a great deal about the determinants of public assistance expenditure using the statistical data which are available and cruder methods than would be required for a perfect solution. The method used was to subdivide total expenditure into expenditures for individual programs and then to resolve these expenditures into the number of recipients and average monthly payments. The effect of changing population has been allowed for by expressing the number of recipients as a rate per thousand persons of the relevant age. The program was then examined in some detail and note made of changes in the program or changes in conditions which appear to explain changes in recipient rates or average payments.

The analysis of changes in the Illinois program over time has been supplemented by a brief comparison of recipient rates and average payments in different geographic areas in Illinois and in the United States. The interstate comparisons are made in three different ways. A crude comparison of Illinois with other states is made by ranking the states according to recipient rates and average monthly payments. A second comparison involves plotting expenditure trends in Illinois and selected industrial and southern states on a logarithmic scale and examining relative rates of growth. Finally, multiple regression analysis has been used in an effort to isolate the factors that are associated with interstate variations in expenditure and to show how Illinois ranks after these factors have been taken into

---

*The author is Associate Professor, Institute of Government and Public Affairs, University of Illinois.

consideration. Because this material is somewhat technical and because only preliminary analysis has been completed, the report of the regression analysis has been put in brief sections which may be omitted by the reader if he desires.

The results of the analysis suggest that the level of employment is a very important determinant of the level of expenditure for public assistance purposes. The number of recipients of public assistance rises sharply in a period of rising unemployment. The correlation is by no means perfect however. In some programs the number of recipients do not fall as rapidly as unemployment declines.

There is also considerable evidence that policy plays a major role in determining the level of expenditure. Evidence of this is found in the fact that substantial changes in expenditures which cannot be explained by economic factors have occurred. In some of these cases it is possible to point to a specific policy change in the form of legislative enactments or administrative policy changes. In other cases, it is not possible to prove that policy changes have, in fact, occurred.

When one goes beyond the simple generalizations of the last two paragraphs to attempt to describe how these factors relate to other factors or to predict the results of possible changes, the task becomes more difficult. It is obvious, for example, that the high rate of illegitimacy and desertion among Cook County negroes is an important immediate cause of children becoming dependent. Yet the fact that the Aid to Dependent Children caseload rises sharply in recessionary periods suggests that there is a relationship between the economic factor (unemployment) and the social factors (illegitimacy and desertion). What is lacking is any clear understanding of how this interaction takes place.

Another problem involves the reversibility of these processes. The recipient rates often do not return to their former levels when unemployment rates fall. Any number of possible explanations for this can be offered but it is difficult to determine which are correct.

Because of the many imponderables involved, highly refined projective technics have not been used. Recipient rates have been projected by extending past trends into the future. Since different factors have affected the various programs and some non-recurring events have been involved, the years used to determine the trend line varies somewhat as does the type of trend fitted.

Projected average payments have been determined in a number of different ways. In some cases deflated average payments have been extended into the future. In other cases medical vendor payments and cash payments are projected separately and in some cases arbitrary sums were chosen.

Since these methods have involved a great deal of personal judgment, the programs, past trends and the methods of projection used are described in considerable detail in the pages that follow. This will permit the reader

to appraise the methods used and modify the result on the basis of his own judgment if he desires.

The Programs

In Illinois, the major public assistance expenditures[1] are in connection with the General Assistance program, administered and financed jointly by local governments and the State, and with the five federally-aided programs administered by the Illinois Public Aid Commission. The five federally-aided programs are:

Old Age Assistance
Aid to Dependent Children
Aid to the Blind (Blind Assistance)
Aid to the Permanently and Totally Disabled (Disability Assistance)
Aid to the Medically Indigent Aged

In April, 1962, for example, 461,444 persons received a total of \$25,361,795 through these six programs. Over 48 percent of these payments were for the support of dependent children and their grantee relatives under the Aid to Dependent Children program. As indicated in Table 1, the average payment per person under this program was \$44.28, but the average payment per case was \$198.60. The breakdown by source of funds in Table 2 shows that 55 percent of the funds paid to recipients of ADC were state funds with the remainder coming from the Federal government.

The second largest program is the Old Age Assistance program. In April, 1962, 66,876 aged persons received \$5,513,701 or 21.7 per cent of public assistance payments. The average recipient received \$82.45 in the form of cash and direct payments to medical vendors.[2]

General Assistance payments accounted for 18.7 percent of April, 1962, public assistance expenditures. Although the total paid in General Assistance was less than the total paid to recipients of Old Age Assistance, the General Assistance program required far more state and local funds. Table 2 shows that the Federal government paid over 60 per cent of Old Age Assistance, while General Assistance was paid entirely from the state and local funds.

Disability Assistance accounted for 10 percent of assistance payments in April, while Blind Assistance made up only one percent of the total.

The program of Assistance to the Medically Indigent Aged was established at the Federal level by the Kerr-Mills bill. The 1961 Illinois State Legislature authorized state participation in the program. This program is, as yet, a very small one in Illinois. Only 189 persons received assistance in April, 1962. The Illinois Public Aid Commission has limited the program to those medical cases which are especially expensive; therefore, the average

[1] The term "public assistance" is used in this report to mean financial assistance to needy persons contingent upon their need. Both cash payments and payments made to medical or other vendors in behalf of such persons are included.

[2] All payment data include medical vendor payments unless otherwise indicated. In the Old Age Assistance and Disability Assistance programs these payments made directly to physicians, hospitals, nursing homes, druggists and other vendors make up a very substantial part of the total. Details as to the nature of these payments and the method of accounting for and reporting them are given later.

monthly payment per case is much higher under this program than under the other assistance programs. In April, 1962, payments in behalf of the 189 persons receiving aid averaged well over $400.

Trends in Public Assistance Expenditure

The developing financial crisis in Illinois has focused attention upon recent sharp increases in public assistance expenditures. These increases will be examined in detail in the program-by-program analysis of expenditure trends which follows. Before turning to this more detailed analysis, however, it is important to place the problem in a somewhat wider perspective by examining some more general, longer-run trends.

TABLE 1

Illinois Public Assistance Programs
Number of Recipients and Amount of Assistance
April 1962

Program	Amount of Assistance	Recipients		Average Assistance	
		Cases	Persons	Per Case	Per Person
Old Age Assistance	$ 5,513,701	66,876	66,876	$ 82.45	$ 82.45
Aid to Dependent Children	12,188,065	61,369	275,219	198.60	44.28
Blind Assistance	263,235	2,876	2,876	91.53	91.53
Disability Assistance	2,566,140	26,257	26,257	97.73	97.73
Assistance to Medically Indigent Aged	78,804	189	189	416.95	416.95
Total Federally Aided Programs	$20,609,945	157,567	371,417	$130.80	$ 55.49
General Assistance	4,751,850	44,005	90,136	107.98	52.72
Total—All Direct Assistance*	$25,361,795	201,547	461,444	$125,84	$ 54.96

SOURCE: Illinois Public Aid Commission.
*Twenty-five cases including 109 persons were transferred from General Assistance to one of the federally-aided programs during the month. These cases have been counted only once.

The present system of public assistance began with the passage of the Federal Social Security Act in 1935. This act established the familiar system of compulsory Old Age and Survivors Insurance and also provided for federal grants to match state and local public assistance payments to specified categories of needy recipients. The categories of persons eligible for these assistance payments were defined so as to exclude those able-bodied persons of working age who were eligible for the emergency federal work relief programs then in operation. It was generally assumed that the cate-

gorical programs would decline in importance as increasing numbers of persons became eligible for retirement or survivors insurance benefits.

In 1935, the year the Social Security Act was passed, an average of 1,132,161 persons received some kind of public assistance or work relief in Illinois. The expansion of the assistance program which resulted from the establishment of the categorical aid program and the recession of 1937-38 combined to push the number of persons receiving aid to an all-time high of 1,338,726 persons in 1938. This was 17.0 percent of the state's popula-

TABLE 2

Illinois Public Assistance Programs
Amounts of Assistance and Source of Funds
April 1962

Program	Total Amount	State Funds		Federal Funds	
		Amount	Percent	Amount	Percent
Old Age Assistance	$ 5,513,701	$ 2,168,785	39.3	$ 3,344,916	60.7
Aid to Dependent Children	12,188,065	6,699,538	55.0	5,488,527	45.0
Blind Assistance	263,235	141,115	53.6	122,120	46.4
Disability Assistance	2,566,140	1,446,840	56.4	1,119,300	43.6
Assistance to Medically Indigent Aged	78,804	39,402	50.0	39,402	50.0
Total Federally Aided Programs	$20,609,945	$10,495,680	50.9	$10,114,265	49.1
General Assistance*	4,751,850	3,374,983	71.0		
Total—All Direct Assistance	$25,361,795	$13,870,663	54.7	$10,114,265	39.9

SOURCE: Illinois Public Aid Commission.
*Includes amounts paid by local government units not receiving state funds. Local funds amounted to 29.0 percent of General Assistance expenditure and 5.4 percent of all assistance expenditure.

tion.[3] Total assistance payments amounted to $227 million or 4.44 percent of the personal income of Illinois residents.

In the years following 1938, rising employment levels and the increasing numbers of persons eligible for Old Age and Survivors Insurance benefits greatly reduced the need for public assistance. The emergency work relief programs for able-bodied persons of working age were abandoned altogether. In 1945, the number of persons receiving public assistance declined to 233,849 persons, just 3.1 percent of the population. Total payments in that year amounted to only .67 percent of state personal income.[4]

---

[3] Illinois Public Aid Commission, Division of Program Analysis and Research, *Selected Public Assistance Indicators in Illinois 1935-1961* (mimeographed), April 11, 1962. Data are for calendar years.
[4] *Ibid.*

The decline in public assistance expenditure was reversed in the post-war years. As Table 3 indicates, Illinois public aid expenditure rose from $78 million in fiscal year 1946 to $253 million in 1961, an increase of 225 percent.

Although this increase is a sharp one, it is well to examine the second and third columns of Table 3 before concluding that the increase in public assistance expenditure is the major cause of the state's financial crisis. The second data column shows that public assistance expenditure was only 18.5

TABLE 3

Illinois Public Assistance Expenditure in Relation to State General Expenditure and Personal Income, 1946-1961

Fiscal Year	Total Public Assistance Expenditure* (thousands of dollars)	Public Assistance Expenditure as Percent of Total State General Expenditure	Public Assistance Expenditure as Percent of Total Expenditure—State Funds Only	Percent of Public Assistance Expenditure as Personal Income
1946	$ 77,915	31.4	23.5	.66
1947	96,323	—†	—†	.74
1948	106,924	25.2‡	18.6‡	.73
1949	124,662	—†	—†	.83
1950	136,382	25.9	19.8	.89
1951	127,001	24.3	18.2	.75
1952	131,451	24.2	17.7	.72
1953	144,185	23.0	17.6	.75
1954	132,685	20.4	13.4	.67
1955	151,589	21.7	14.8	.74
1956	153,346	20.7	15.3	.70
1957	165,931	19.0	13.3	.71
1958	178,525	15.7	10.9	.74
1959	214,746	17.0	13.3	.86
1960	230,477	19.0	15.3	.89
1961	252,593	18.5	15.1	.94

SOURCE: Illinois Public Aid Commission expenditures from Annual Reports of Illinois Department of Finance. Illinois general expenditure data from publications of U. S. Census Bureau. Personal income data from U. S. Department of Commerce. Fiscal year personal income was approximated by averaging income of two calendar years in which the fiscal year falls.

*Public Assistance expenditure reported here includes all expenditure of the Illinois Public Aid Commission and, prior to 1952, sums apportioned to local units by the Auditor of Public Accounts as emergency relief (General Assistance).

†State General Expenditure for 1947 and 1949 not available on a comparable basis.

‡In computing percentages for 1948, expenditures for veteran's bonus were excluded from total general expenditures.

percent of state general expenditure in 1961 although it had been 31.4 percent in 1946. Perhaps a better reflection of the effect of public aid expenditures upon the state's financial position is found in the third column. These figures show public assistance expenditure from state funds as a percentage

of state general expenditure from state funds. That is, federal grants have been substracted from public assistance expenditure and from state general expenditure, before dividing, to obtain the percentage of state-raised funds expended for public assistance. These figures also show that public assistance expenditures account for a smaller portion of state spending in 1961 than they did in 1946, although the difference is somewhat less marked than when the data are unadjusted for Federal aid.

Although public assistance expenditure in Illinois has not risen as fast as has state general expenditure, it has risen faster than personal income. This fact, clearly shown in the last column of Table 3, raises a number of important questions. Does this tendency result from a policy of using a larger portion of rising income to meet more fully the needs of less fortunate

TABLE 4

Illinois Public Assistance Expenditure* by Program, as Percent of Total, 1946-1961

Fiscal Year	Old Age Assistance	Aid to Dependent Children	Blind Assistance	Disability Assistance	General Assistance	Burial Grants	Administration	Total
1946	63.9	19.4	2.8	—	7.7	0.3	6.0	100.0
1947	61.4	22.3	2.4	—	8.4	0.3	5.3	100.0
1948	59.1	20.5	2.3	—	12.7	0.2	5.2	100.0
1949	55.8	21.9	2.1	—	14.8	0.2	5.2	100.0
1950	51.8	21.5	1.9	—	19.3	0.2	5.3	100.0
1951	52.7	21.4	2.0	0.2	17.3	0.3	6.1	100.0
1952	51.7	23.2	2.1	1.3	14.6	0.3	6.9	100.0
1953	52.2	22.6	2.0	2.6	13.4	0.5	6.8	100.0
1954	50.8	22.1	2.0	3.4	14.4	0.3	7.0	100.0
1955	45.6	20.9	1.8	3.7	21.2	0.4	6.3	100.0
1956	43.3	23.5	1.8	4.3	20.5	0.3	6.2	100.0
1957	41.0	25.9	1.7	6.1	18.7	0.4	6.1	100.0
1958	37.3	27.2	1.6	7.6	19.5	0.3	6.4	100.0
1959	30.6	28.6	1.4	8.0	24.6	0.3	6.5	100.0
1960	28.2	29.2	1.3	7.5	26.8	0.2	6.8	100.0
1961	26.2	29.8	1.1	7.6	27.5	0.2	7.5	100.0

SOURCE: Computed from Annual Reports of Illinois Department of Finance.
*Public Assistance expenditure reported here includes all expenditure of the Illinois Public Aid Commission and, prior to 1952, sums apportioned to local units by the Auditor of Public Accounts as emergency relief (General Assistance).

citizens, or does it result from an increase in these needs? If it is the latter, does this mean that the Illinois economy has failed to provide economic opportunities for a substantial number of its citizens, or does it indicate an increase in those social problems which create economic dependency? Although a purely fiscal analysis cannot answer these questions fully, the

analysis of the individual programs which follows will shed some light on the problem.

The relative importance of the various public assistance programs has changed drastically in the postwar years. In fiscal year 1946, Old Age Assistance was by far the most expensive program, accounting for 63.9 percent of expenditures. In fiscal year 1961, however, Old Age Assistance accounted for only 26.2 percent of the total. Aid to Dependent Children expenditure, on the other hand, grew from 19.4 percent of the total to 29.8 percent.[5] General Assistance expenditure was the third largest item in 1961, accounting for 27.5 percent of all expenditure. It should be noted that the term "General Assistance" as used in Table 4 refers to the appropriation item and not to the locally administered General Assistance program. The appropriation item has, at various times, included funds used for several purposes in addition to grants to local units for the General Assistance program. Among these are such items as payment of the administrative costs of the federal surplus commodity distribution, supplementation of grants in the federally-aided programs, and payments made to Cook County for care rendered medically indigent persons from Chicago and Cicero at Cook County Hospital.

The seventh column of Table 4 indicates the percentage of public assistance expenditures spent for administrative purposes. This ratio should not be considered as a measure of administrative efficiency. An extremely low ratio could be achieved by making little investigation of claims and by providing no retraining or rehabilitation services. An efficient administration, on the other hand, might have a fairly high ratio as a result of following the opposite policy in each of these matters. Variation in the percentage of total expenditure devoted to administration also results from changes in the importance of the various programs. Administrative expenses for Old Age Assistance and Blind Assistance would normally be much lower than for Aid to Dependent Children or General Assistance since changes in eligibility and need are much less frequent in the first two programs.

Aid to Dependent Children

The Federal Social Security Act states the purpose of the Aid to Dependent Children program in these words:

> For the purpose of encouraging the care of dependent children in their own homes or in the homes of relatives by enabling each State to furnish financial assistance and other services, as far as practicable under the conditions in such State, to needy dependent children and the parents or relatives with whom they are living to help maintain and strengthen family life and to help such parents or relative to attain the maximum self-support and personal independence consistent with the maintenance of continuing parental care and protection . . .[6]

"Dependent child" is defined to mean a child under 18 years of age who

[5] The much greater relative importance of the Aid to Dependent Children program indicated by Table 2 emphasizes the very rapid growth of that program in recent months.

[6] 42 U.S.C. Sec. 601.

has been deprived of parental support or care by reason of the death, continued absence from the home, or physical or mental incapacity of a parent and who is living with one of a specified class of relatives.[7]

"Aid to dependent children" includes money payments, medical care and any type of remedial care recognized by state law provided to meet the needs of the child and the relative with whom he or she lives.[8]

The Federal statutes provide that grants are to be made to states which have submitted an acceptable plan to the Secretary of Health, Education and Welfare. The Secretary is directed to approve any plan which meets the following conditions:[9]

1. The plan must be in effect in all political subdivisions of the state.

2. The plan must provide for financial participation by the state.

3. Provision must be made to have a single state agency administer or supervise administration of the plan for aid to dependent children.

4. Opportunity must be provided for a fair hearing to any individual whose claim for aid is denied or not acted upon with reasonable promptness.

5. Methods of administration must meet the Secretary's standards for proper and efficient operation. There must be a merit plan for personnel.

6. Provision must be made to supply the Secretary with such reports as he may require and to comply with any provisions which the Secretary may find necessary to verify the correctness of the reports.

7. The state agency, in determining need, must take into account any other income or resources of the child claiming aid.

8. The plan must provide safeguards which restrict the use of information concerning applicants and recipients to purposes directly connected with administration of the program. (However, federal legislation passed in 1951 provides that no state may be deprived of payments because of state legislation permitting public access to disbursement records, provided that the legislation prohibits the use of lists or names so obtained from being used for political or commercial purposes.[10])

9. It must be provided that all persons wishing to make application for aid shall have an opportunity to do so and that all eligible persons shall receive aid with reasonable promptness.

10. Appropriate law enforcement officials must be notified of the furnishing of aid to a child who has been deserted or abandoned by a parent.

11. No aid may be furnished any individual under the Aid to Dependent Children program who is also receiving Old Age Assistance.

12. A description of the services which the agency makes available to maintain and strengthen family life for children must be made available.

13. No more than one year's residence may be required as a condition of eligibility for aid.

---

[7] 42 U.S.C. Sec. 606.
[8] 42 U.S.C. Sec. 606.
[9] 42 U.S.C. Sec. 602.
[10] 65 Stat. 569.

Beginning on May 1, 1961, the Aid to Dependent Children program was expanded to include a child deprived of parental support because of the unemployment of a parent.[11] This provision was to expire on June 30, 1962, but has been extended through June 30, 1967.[12] To be eligible to participate in the program, a state must establish an arrangement with the public employment offices of the state looking toward the employment of the parent and provide for denial of aid if the parent refuses a suitable job offer. The 1962 amendments provide that both parents may be counted for federal matching purposes when the child's dependency results from unemployment. Previously, only one grantee-relative could be counted in computing the federal share.

Other 1961 legislation which was extended in 1962 provides for continuing the grant of a child removed from the home of a relative subsequent to April 30, 1961, and placed in a foster home as a result of a judicial determination to the effect that continuation in the original home would be contrary to the welfare of the child. No matching is provided for children removed prior to April 30, 1961.

The federal government's grants to the states are equal to fourteen-seventeenths of the first $17.00 average monthly payments plus 50 percent[13] of the next $13.00.

In the past the Federal government has matched administrative costs on a 50-50 basis, but the 1962 amendments provide that the Federal government will pay 75 percent of the costs of services specified by the Secretary of Health, Education and Welfare as minimum services necessary to reduce dependency and permits recipients to attain or regain self-support or to strengthen and maintain family life for children. The Federal government will also pay 75 percent of the cost of training personnel employed by agencies administering the program.

The Aid to Dependent Children program became operative in Illinois after enabling legislation was passed by the General Assembly in 1941. Administration of this program, like all of the federally-aided programs in Illinois, is directed by the Illinois Public Aid Commission. This commission is a bipartisan commission consisting of the Auditor of Public Accounts, the State Treasurer, the Director of the Department of Finance and seven members appointed by the Governor with the advice and consent of the Senate. County departments of public aid in each county are staffed by Commission employees except in Cook County where the Cook County Department of Public Aid serves as agent of the Commission in administering the program.

Illinois statutes define a dependent child as a needy child under the age of 16, or under 18 if in regular attendance at school, who has been de-

[11] 42 U.S.C. Sec. 607 (Supp. III, 1962).

[12] Public Law 87-543, approved July 25, 1962.

[13] This percentage varies from 50 to 65 percent depending upon the income of the state. As a high income state, Illinois receives the minimum percentage.

prived of parental support or care by reason of the death, continued absence from home, or physical or mental incapacity of the parent. The child must be living with a relative or be under the care of certain child welfare agencies as a result of a petition filed by the County Superintendent of Public Aid.[14]

Legislation passed in 1961 extended coverage to children deprived of support or care as the result of unemployment or insufficient earnings of a parent or parents during such time as federal aid is granted in behalf of such children.[15] The first payments under this program, known as the ADC-U program, were made in May, 1961.

When the parent, or parents, of a dependent child are failing to meet their legal obligation to support the child, the parent or other relative with whom the child is living is required, by the statutes, to request the State's Attorney or other law enforcement official to file action to enforce the support obligation. If this relative refuses to file action the statutes require that aid be discontinued unless the county department determines that such action would be unavailing or impractical. The county department may, under the rules and regulations of the Commission, provide services and assume reasonable costs in connection with such support action.[16]

Illinois law provides that a child is eligible for assistance only if he or the relative with whom he is living has been a resident of the state for one year.[17] This is the maximum period of residence permitted by Federal law.

The statutes provide that the home of each dependent child shall be visited at least once in three months. It is also provided that if the home is not suitable, the County Superintendent of Public Aid shall institute legal action to have the child removed.

The amount of aid granted is to be sufficient, when added to the income, money contributions, and other support and resources available to the child to provide a reasonable subsistence compatible with health and well-being.[18] To aid the caseworker in carrying out this provision, the Illinois Public Aid Commission provides a Monthly Budget Chart[19] for each county. These charts list the amounts to be allowed persons of various ages for such items as food, clothing, household supplies, and personal incidentals. The allowance for shelter is the rent or property carrying charges actually paid, provided the cost does not exceed a fair amount for modest housing.

Once the total needs have been determined, the caseworker substracts any other income such as wages or support payments, insurance or social security payments, to obtain the amount of money assistance to be granted.

Medical needs of recipients are met by means of direct payments to vendors such as physicians, hospitals, pharmacies, and nursing homes. A

[14] Ill. Rev. Stat. C. 23, Par. 601 (1961).
[15] Ill. Rev. Stat. C. 23, Par. 607 (1961).
[16] *Ibid.*
[17] Ill. Rev. Stat. C. 23, Par. 602 (1961).
[18] Ill. Rev. Stat. C. 23, Par. 603 (1961).
[19] Actually a table.

rather elaborate system of advisory committees is used in connection with the administration of the medical programs. The IPAC appoints a General Advisory Committee on Health whose membership includes representative from the fields of medicine, dentistry, public health nursing, medical social work and family welfare. The State Medical Advisory Committee is composed of physicians; its members are appointed yearly by the Chairman of the Council of the State Medical Society. This committee meets from six to eight times a year and gives the Commission staff advice on questions relating to physicians' services, drugs, and medical care problems.[20] Similar functions are assigned to the State Dental Committee, the Subcommittee on Radiology, the Subcommittee on Anesthesiology, the State Ophthalmology Committee, and the State Drug Advisory Committee. There is also a technical advisory committee on purchase of hospital care, concerned mainly with advising on rates of payment for hospital care.

The statewide committees work with the IPAC Division of Medical Services which has the responsibility of establishing quality, quantity, and cost standards, which are embodied in rather detailed regulations concerning the conditions under which certain services may be rendered and the maximum charges to be made. Requests for deviations from these established standards are reviewed by the county staffs and may be discussed with the appropriate county advisory committee or with the IPAC Division of Medical Services.

At the county level, there are medical and dental advisory committees and one or more drug advisors. Usually these committees meet monthly with members of the staff of the county department of public aid to review bills and medical situations in individual cases.

Recipient Rates. In July, 1951, there were 82,277 persons receiving assistance under the ADC program in Illinois. The May, 1962, figure was 3⅓ times as large. Part of this very rapid increase can be explained by the simple fact that there were more children and thus more potential recipients on the latter date. It is possible to allow for the increased child population by relating the number of persons receiving assistance to the population aged 17 and under. The "recipient rate," or number of recipients per 1,000 persons aged 0-17 has increased from 32.4 in July, 1951, to 75.9 in May, 1962.[21] The latter figure is about 2⅓ times the former, still a very large increase in a period generally considered to be a prosperous one.

The fluctuations in the ADC recipient rate during the period can be traced in Chart 1. It is obvious from this chart that there has been a sustained rise in the recipient rate since early in 1958 and that the rate of increase has accelerated since late in 1960 or early in 1961. The extremely rapid rate of increase in the recipient rate during the latter part of the period is

[20] Illinois Public Aid Commission Exhibit M, 11-10-60.

[21] It is incorrect to assume that the recipient rate indicates the proportion of children receiving assistance since the number of recipients include one or more adults per case. Before the ADC-U program went into effect only one adult per case was generally included.

made more vivid by a close look at the rate of increase since the inauguration of the ADC-U program. During the 13 month period from May, 1961, to May, 1962, inclusive, the recipient rate has risen by one-half, from 50.1 to 75.9. This represents an average increase of two points per month. Even if the ADC-U program is omitted from consideration, the rise amounts to almost one point per month.

The increase in the recipient rate which occurred during the ten year period has been accompanied by a change in the character and geographic distribution of the caseload. An increasingly large portion of the recipients are concentrated in Cook County and, to a lesser extent, the urban areas downstate. In 1951, 62 percent of the recipients were residents of Cook County. In May, 1962, almost 71 percent were from Cook County.

It is more difficult to document the change in the character of the caseload with exact figures for the time period under consideration, but

TABLE 5

Major Crisis Leading to Dependency of ADC Families in Illinois June, 1960

Major Crisis	Percent of Families
Desertion by father	39.9
Mother unmarried	32.1
Incapacity of father	9.5
Divorce or legal separation	8.4
Incarceration of parent	4.0
Death of father	3.9
Death of mother	1.2
Desertion by mother	0.8

SOURCE: Illinois Public Aid Commission, *Aid to Dependent Children* (mimeographed), Exhibit N-2, November 10, 1960.

there is ample evidence that a fundamental, long-term change has occurred. During the first years of the Aid to Dependent Children program the majority of children receiving assistance were in need because of the death of their father.[22] As the number of fatherless children eligible to receive payments under the Old Age and Survivors Insurance provisions of the Social Security Act has increased, the death of the father has become a minor cause of dependency under the ADC program. In 1960 the major causes of dependency were illegitimacy and desertion by the father. A tabulation showing the relative importance of various major crises leading to dependency is presented in Table 5.

A recent study of the whereabouts of the father of ADC families in

[22] Illinois Public Aid Commission, *Aid to Dependent Children* (mimeographed), Exhibit N-2, Nov. 10, 1960.

Cook County confirms the general impression conveyed by Table 5. The result of this study is summarized in Table 6.

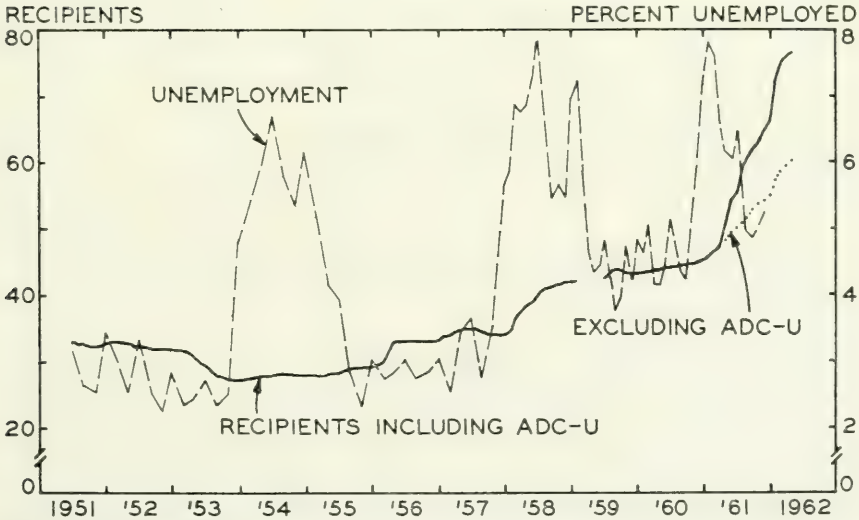
TABLE 6
Status of Principal Father, Sample of ADC Families in Cook County, Illinois

Status of Father	Percent of Fathers
Dead	4.6
Incapacitated	4.0
Needed in Home	0.9
Absent—Total	90.6
Divorced or legally separated	6.6
Separated without court degree	3.5
Deserting	38.2
Not married to mother	38.6
Imprisoned	1.9
Absent for other reasons	1.8

SOURCE: Greenleigh Associates, Inc., *Facts, Fallacies and the Future. A Study of the Aid to Dependent Children Program of Cook County, Illinois* (New York, 1960).

CHART 1

Number of ADC Recipients per 1,000 Population Under 18 and Percent of Civilian Labor Force Unemployed



SOURCE: See Appendix.

A large number of ADC families are non-white and a high percentage of the adult grantees have previously lived in other states. In 1960, 75 percent of the caseload was composed of non-white families and 73.3 percent

of the adult grantees had previously lived outside Illinois. Thirty percent of the adult grantees had previously lived in a single state, Mississippi.

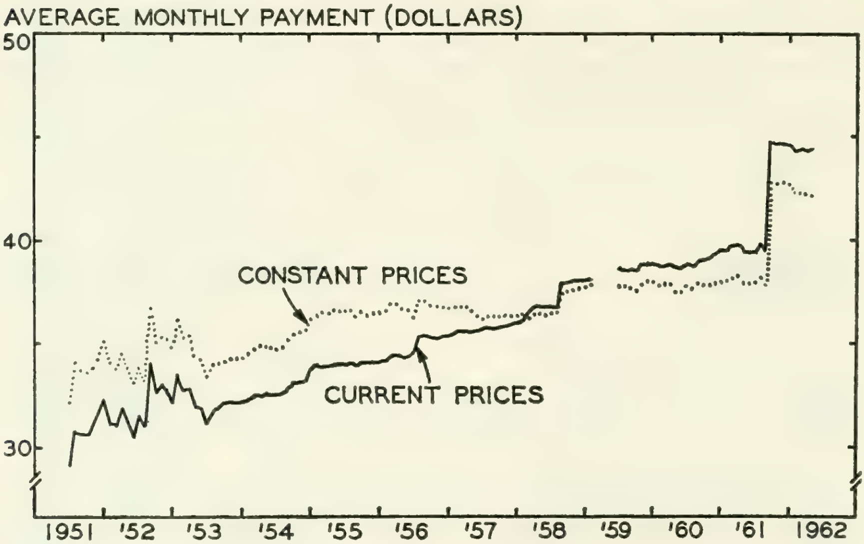
Although the trend for ADC to become a program of assistance to non-white, urban dwellers with low levels of education and skills appears to be continuing with respect to the regular program, some new factors have been introduced with the inauguration of the ADC-U program.

The number of children in ADC-U families tends to be greater than in families receiving assistance in the regular program. A higher proportion in the ADC-U program are white and a higher proportion live downstate. A high proportion of the mothers in ADC-U families have never been employed outside the home.

Average Payment. The monthly budget chart used by the caseworker to determine the payment to each case shows the amounts to be allowed

CHART 2

Average Monthly Payments, Aid to Dependent Children



SOURCE: See Appendix.

for recipients of various ages in families of various sizes. The main body of the charts currently in use in three counties are shown in Table 7. Not shown in Table 7 are various adjustments made for persons in special circumstances. For example, there are downward adjustments if a recipient is bedfast or receives meals as part of his salary. Increases are provided in the food allowances of pregnant women and the clothing allowance of working persons. Special allowances are made if it is necessary for the person to eat in restaurants or to have laundry done commercially. Occasionally, emergency allowances for such items as furniture, child care or "fringe" medical items are granted.

Utility allowances are based upon units of consumption, such as kilowatt hours of electricity, therms of gas, gallons of oil, or tons of coal. The caseworker must determine the local price and compute the amount to be allowed. The shelter allowance is based upon the rent or carrying charges actually paid for modest housing. Medical costs are paid directly to the vendor from the pooled medical fund.

TABLE 7
Monthly Budget Table—Aid to Dependent Children
(Personal Allowances Only)*

	Number of Persons in Household	Food	Clothing	Household Supplies & Equipment	Personal Incidentals	Total Personal Allowance
			(ALEXANDER COUNTY)			
Adult	2	$26.15	$5.65	$1.45	$3.65	$36.90
	3 or 4	23.75	5.65	1.25	3.65	34.30
	5 to 7	22.55	5.65	1.25	3.65	33.10
	8 or more	21.40	5.10	1.05	3.65	31.20
Child	2	14.60	3.50	1.45	.95	20.50
under	3 or 4	13.25	3.50	1.25	.95	18.95
6 years	5 to 7	12.60	3.50	1.25	.95	18.30
	8 or more	11.95	3.35	1.05	.95	17.30
Child	2	21.90	5.20	1.45	2.00	30.55
6 to 12	3 or 4	19.90	5.20	1.25	2.00	28.35
years	5 to 7	18.90	5.20	1.25	2.00	27.35
	8 or more	17.90	4.95	1.05	2.00	25.90
Child	2	27.50	7.40	1.45	3.85	40.20
13 to 19	3 or 4	25.00	7.40	1.25	3.85	37.50
years	5 to 7	23.75	7.40	1.25	3.85	36.25
	8 or more	22.50	7.40	1.05	3.85	34.80
			(COOK COUNTY)			
Adult	2	27.10	5.65	1.45	4.05	38.25
	3 or 4	24.65	5.65	1.25	4.05	35.60
	5 to 7	23.40	5.65	1.25	4.05	34.35
	8 or more	22.20	5.10	1.05	4.05	32.40
Child	2	15.50	3.50	1.45	1.00	21.45
under	3 or 4	14.10	3.50	1.25	1.00	19.85
6 years	5 to 7	13.40	3.50	1.25	1.00	19.15
	8 or more	12.70	3.35	1.05	1.00	18.10
Child	2	23.10	5.20	1.45	2.10	31.85
6 to 12	3 or 4	21.00	5.20	1.25	2.10	29.55
years	5 to 7	19.95	5.20	1.25	2.10	28.50
	8 or more	18.90	4.95	1.05	2.10	27.00

Table 7 continues on page 112

The average payment per ADC recipient in July, 1951, was $29.12. In April, 1962, it was $44.28.[23] Table 8 shows the distribution of payments by size in October, 1961. Although 96 per cent of the cases received less than $325.00 there were 25 cases which received over $500.00. In 21 of the

[23] The earlier figure includes payments to medical vendors. The 1962 figure includes payments into the medical fund. The operation of this fund is explained in a later section of this report.

TABLE 7 (Continued)
Monthly Budget Table—Aid to Dependent Children
(Personal Allowances Only)*

	Number of Persons in Household	Food	Clothing	Household Supplies & Equipment	Personal Incidentals	Total Personal Allowance
Child	2	28.90	7.40	1.45	4.20	41.95
13 to 19	3 or 4	26.25	7.40	1.25	4.20	39.10
years	5 to 7	24.95	7.40	1.25	4.20	37.80
	8 or more	23.65	7.40	1.05	4.20	36.30
		(PUTNAM COUNTY)				
Adult	2	28.35	5.65	1.45	3.90	39.35
	3 or 4	25.75	5.65	1.25	3.90	36.55
	5 to 7	24.45	5.65	1.25	3.90	35.25
	8 or more	23.20	5.10	1.05	3.90	33.25
Child	2	15.85	3.50	1.45	1.00	21.80
under	3 or 4	14.40	3.50	1.25	1.00	20.15
6 years	5 to 7	13.70	3.50	1.25	1.00	19.45
	8 or more	12.95	3.35	1.05	1.00	18.35
Child	2	23.85	5.20	1.45	2.10	32.60
6 to 12	3 or 4	21.70	5.20	1.25	2.10	30.25
years	5 to 7	20.60	5.20	1.25	2.10	29.15
	8 or more	19.55	4.95	1.05	2.10	27.65
Child	2	30.00	7.40	1.45	4.10	42.95
13 to 19	3 or 4	27.25	7.40	1.25	4.10	40.00
years	5 to 7	25.90	7.40	1.25	4.10	38.65
	8 or more	24.55	7.40	1.05	4.10	37.10

SOURCE: Illinois Public Aid Commission.
*In addition to personal allowances, most cases receive allowances for shelter and utilities. Other special or emergency allowances may be granted in special cases. Most medical expenses are handled by means of direct payments to vendors. See text for details.

25 cases there were nine or more persons in the family. Lower allowances for families of eight or more persons were introduced in July, 1962, so it is likely that payments to these large families would be somewhat lower today. However, the fact that unusual occurence may result in even small families receiving large payments in a particular month is evidenced by the fact that one of the 25 families which received over $500.00 in October, 1961, was a family of only two persons. Slightly over nine per cent of the cases received less than $75.00. Although there were more two-person families than any other size of family in this group, a substantial portion of the cases receiving less than $75.00 were larger families. Since the personal allowance for a two-person family plus even a token shelter allowance would exceed $75.00, it is likely that the great majority of these families had other sources of income.

The fluctuation in the average payments which have occurred during this period is shown graphically in Chart 2. It is important to remember that the data shown in Chart 2 are simple averages computed by dividing total payments to recipients by the total number of recipients. The factors which cause fluctuations in these averages are of two kinds. One set of

factors may cause a change in the actual payments made to or in behalf of a particular case when such characteristics are family size, outside income, and place of residence remain unchanged. A change in the budget charts, or

TABLE 8

Distribution of Aid to Dependent Children Cases, by Monthly Payment, October 1961

Amount of Payment	Number of Cases Cook County	Number of Cases Downstate	Percent of Cases* Cook County	Percent of Cases* Downstate	Cumulative Percentage¶ Cook County	Cumulative Percentage¶ Downstate
Under $25	188	307	0.5	2.1	.5	2.1
25-49	571	784	1.6	5.4	2.1	7.6
50-74	1,248	1,419	3.5	9.9	5.7	17.4
75-99	1,737	1,707	4.9	11.9	10.5	29.3
100-124	2,756	2,243	7.8	15.6	18.3	44.9
125-149	4,578	2,114	12.9	14.7	31.2	59.6
150-174	5,225	1,781	14.7	12.4	45.9	71.9
175-199	4,928	1,334	13.9	9.3	59.8	81.2
200-224	4,226	978	11.9	6.8	71.7	88.0
225-249	3,113	676	8.8	4.7	80.5	92.7
250-274	2,316	430	6.5	3.0	87.0	95.7
275-299	1,632	272	4.6	1.9	91.6	97.6
300-324	1,135	171	3.2	1.2	94.8	98.8
325-349	753	94	2.1	0.7	96.9	99.4
350-374	457	44	1.3	0.3	98.2	99.7
375-399	272	20	0.8	.1	99.0	99.9
400-424	171	12	0.5	.1	99.4	99.9
425-449	99	4	0.3	•	99.7	99.9
450-474	46	2	0.1†	•	99.8	99.9
475-499	31	1	0.1‡	•	99.9	99.9
500 and over	23	2	0.1§	•	100.0	100.0
Total	35,505	14,395	100.0	100.0		

SOURCE: Illinois Public Aid Commission.
*Rounded to nearest one-tenth of one percent.
†.12956
‡.08731
§.06478
¶Rounded to nearest one-tenth of one percent but computed from data carried to five decimal places.
•Less than .05

a change in rents, or prices of medical services are examples of how changes of this kind might occur.

The other set of factors result from the fact that the average is not weighted to take account of changes in the proportion of high and low payment families. The average might be higher in a later period because

a higher proportion of the recipients live in Cook County where higher rents make the average payment higher or because of changes in family size.

An elaborate statistical analysis would be necessary to separate the effects of these two kinds of factors completely. It is possible, however, to make some fairly simple estimates of the effect of some of the factors involved. Budget charts for each of the 102 counties are available for the period under consideration. To compute the exact effect of changes in the charts it would be necessary to weight the results to allow for the relative importance of each county and the relative importance of each family size within each county. However, since the changes have been fairly uniform, a reasonably accurate idea of the effect of changes in the budget charts can be obtained by examining the changes which have occurred in the allowances granted to typical families in a representative group of counties.

Table 9 illustrates the changes in the personal allowances in three counties. These allowances are computed for families of 2, 4 and 8 members of specified ages. It is assumed that the adult member of the family is active and that there are no special allowances because of pregnancy, employment or lack of laundry facilities.

The statutes provide that the Illinois Public Aid Commission shall make periodic surveys of cost of living factors. It is the policy of the Illinois Public Aid Commission to survey food prices twice yearly in each county. If a survey shows that the cost of a basic "market basket" of food for a family of four has changed by more than 3 percent since the last change, food allowances for that county are recalculated using the new prices. In the period beginning with July, 1951, and ending with September, 1961, changes in personal allowances were very moderate. For the nine cases studied, the net increase for the ten year period ranged from 2.24 percent to 4.5 percent. In October, 1961, however, there was a substantial rise in the allowances. This increase resulted from a revision in the budget standards and changes in the prices of non-food items, as well as from the normal adjustments in food prices.[24] Food allowances in the new standards are adaptations of the Low Cost Food Plan of the U. S. Department of Agriculture published in 1959 and replace allowances based upon a similar plan published by the Department of Agriculture in 1948. The 1959 plan is based upon nutritive requirements recommended by the National Research Council and contain less starch than the previous plan.

Allowances for personal incidentals were increased to reflect the increased cost of items such as haircuts, school supplies, and transportation.

---

[24] The Greenleigh Report on the ADC program in Cook County concluded that existing allowances were not sufficient to provide a "reasonable subsistence compatible with health and well-being" in anything but the rent allowance. The report states that allowances were at least 25 per cent too low in all other respects. Greenleigh Associates, Inc., *Facts, Fallacies and the Future; A Study of the Aid to Dependent Children Program of Cook County, Illinois* (New York, 1960), pp. 41-42.

TABLE 9

Trends in Personal Allowances
Typical Aid to Dependent Children Families, Selected Counties

	Two Persons	Size of Family* Four Persons	Eight Persons
Alexander County			
July, 1951	$57.05	$ 85.60	$176.15
August, 1953	55.60	83.90	172.45
May, 1954	54.45	82.25	168.90
August, 1956	55.55	84.05	172.70
April, 1958	56.85	85.70	176.15
September, 1958	58.10	87.25	179.40
September, 1959	56.50	84.70	174.40
September, 1960	58.50	88.10	181.20
October, 1961	67.45	100.55	206.30
July, 1962	67.45	100.55	195.60
Cook County			
July, 1951	57.95	87.00	178.70
April, 1953	55.90	84.60	173.95
August, 1956	56.75	86.05	176.70
September, 1958	59.25	89.10	183.10
October, 1961	70.10	104.85	215.10
July, 1962	70.10	104.85	204.00
Putnam County			
July, 1951	59.40	88.50	181.75
December, 1954	58.10	87.15	178.95
August, 1956	60.30	90.75	186.15
September, 1958	61.75	92.25	189.40
April, 1959	59.95	89.90	184.80
September, 1960	61.50	92.35	189.95
October, 1961	71.95	107.10	219.70
July, 1962	71.95	107.10	208.35

SOURCE: Computed from budget charts provided by Illinois Public Aid Commission.
*The following age composition is assumed for the hypothetical families:

TOTAL	ADULT	UNDER 6	6-12	13-19
2	1	0	1	0
4	1	2	1	1
8	1	3	3	0

The clothing allowances were increased to reflect price changes, but the same lists of clothing were used.[25]

In July, 1962, supplements to the budget charts were issued. Prior to that time, families of more than five persons were in one category. The new charts provide lower allowances for families of more than eight persons. As

[25] For a more detailed description of the standards adopted in 1961 see: Illinois Public Aid Commission, *Adjustments in the Standard Budget* (mimeographed), Exhibit O, August 11, 1961.

can be seen from data in Table 9, this resulted in a substantial decline in the allowances to larger families.

The increase for the entire period covered by Table 9 ranged from 17.12 percent to 20.97 percent for families of two and four persons and from 11.04 to 14.64 percent for families of eight persons. In the same period, the consumer price index increased by 16.0 percent while the food component of the index increased by 8.2 percent.[26] It would appear, therefore, that there was a decline in the purchasing power of the personal allowances granted a typical ADC family in the ten year period beginning on July, 1951, but that the increases of October, 1961, brought the purchasing power of the personal allowances to a level higher than it was in July, 1951.[27]

Relatively little information concerning trends in the average rental payment made by ADC recipients is available. It is known, of course, that a high proportion of the recipients in Cook County live in slum areas and that the rentals are very high considering the quality of the housing. The following tabulation indicates the relative importance of rent in the budget of ADC recipients and also indicates the difference in rents in Cook County and the rest of the state as of July, 1962:

	Percent of Cases With Rent	Average Rent Per Case
Cook County	99.0	$70.46
Downstate	84.7	31.75
State	94.9	60.52

Interstate Comparisons. In Table 10, the states are ranked according to the average ADC recipient rate during the 1960 fiscal year. At that time, Illinois ranked 20th, with a rate of 4,221 recipients per 100,000 population. The Illinois rate was slightly below the rate in Pennsylvania, New York and California, but well above the rates in some other large industrial states such as Michigan, Connecticut, Massachusetts, and Indiana. It will be noted that the states with the highest recipient rates are generally low income Southern states, with economically depressed West Virginia leading the list.

Table 11 shows the average monthly payment per recipient for a month near the middle of fiscal year 1960. Illinois ranked eleventh in this regard. If the states are ranked in terms of average payment per case for the same month, Illinois will be found to rank third, with only Wisconsin and New York having a higher average. Per case comparisons present serious limitations, however, since there are substantial variations in number of recipients per case. Some of these variations are due entirely to differences in administrative procedures.

Unfortunately, data are not yet available which will permit a study of

[26] Computations based upon the increase from 1951 yearly average to the monthly index for March, 1962.

[27] This comparison cannot be exact because the Consumer Price Index is based upon the purchase of a moderate income family. However, due to the heavy weight of food allowances in the personal allowances granted ADC recipients, it is probably safe to conclude that the cost of items in the allowance increased by approximately 10 per cent.

the trend of recipient rates and average payments during the 10 year period, but it is possible to study total monthly expenditure for these years. Charts 3 and 4 indicate the trends. The vertical scale of these charts is a semilog or ratio scale. When data are plotted on such a scale, equal vertical distances represent equal percentage changes, regardless of the position of the data on the chart. These charts are designed to permit comparison of the rate of growth of expenditure, but since the data are not adjusted for the size (population) of the state, they tell us little about the relative magnitude of expenditure in the various states. By reading the charts in connection with Table 10 and 11, it is possible to get a general picture of both the magnitude

TABLE 10

Aid to Dependent Children

Average Number of Recipients per 100,000 Population Under 18 Years of Age, Fiscal Year 1960

Rank	State	No. of Recipients	Rank	State	No. of Recipients
1	West Virginia	11,304	26	Georgia	3,737
2	Mississippi	8,275	27	Nevada	3,623
3	Oklahoma	7,594	28	Iowa	3,306
4	Louisiana	7,637	29	Maryland	3,245
5	New Mexico	6,948	30	Utah	3,244
6	Missouri	6,818	31	Michigan	3,190
7	Alabama	6,705	32	Oregon	3,183
8	Kentucky	6,455	33	Vermont	3,118
9	Tennessee	6,184	34	South Carolina	3,100
10	North Carolina	5,831	35	Kansas	2,945
11	Florida	5,817	36	Connecticut	2,836
12	Maine	5,769	37	Ohio	2,812
13	Rhode Island	5,714	38	Massachusetts	2,807
14	Arizona	5,395	39	Idaho	2,792
15	Pennsylvania	4,922	40	Montana	2,676
16	New York	4,880	41	North Dakota	2,674
17	California	4,730	42	Minnesota	2,624
18	Alaska	4,554	43	Virginia	2,561
19	Colorado	4,245	44	Texas	2,480
20	ILLINOIS	4,221	45	Indiana	2,458
21	South Dakota	4,094	46	Wisconsin	2,312
22	Arkansas	4,092	47	New Jersey	2,173
23	Delaware	3,839	48	Nebraska	2,129
24	Hawaii	3,815	49	Wyoming	2,103
25	Washington	3,745	50	New Hampshire	1,891
				All States	4,280

SOURCE: Computed from Social Security Bulletin and 1960 U.S. Census Reports.

and trend of Illinois ADC expenditure relative to the other states. The trend in Illinois expenditure is compared with the trend of expenditure in several other large industrial states in Chart 3. Examination of this chart reveals that the rate of growth of expenditure has been substantially greater in Illinois than in any of the industrial states with which comparison is made, or than in the U. S. as a whole. Although the more rapid increase in Illinois occurred during 1961 and 1962, the Illinois rate of increase has been generally higher throughout the period. For example, Illinois expenditure doubled in the period from July, 1951, to July, 1958. Of the industrial states listed, only Ohio increased its expenditure as rapidly during this period.

Regression Analysis. Very little is known about the factors which de-

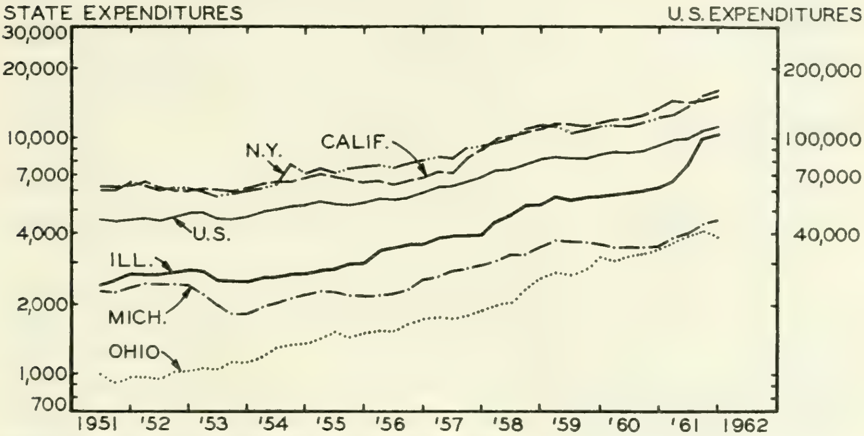
TABLE 11
Aid to Dependent Children
Average Monthly Payment Per Recipient, January, 1960

Rank	State	Payment	Rank	State	Payment
1	Connecticut	$48.32	26	Pennsylvania	$31.73
2	Washington	45.70	27	Oklahoma	31.69
3	California	45.52	28	New Mexico	30.48
4	Wisconsin	45.44	29	Vermont	30.28
5	Massachusetts	45.20	30	Nebraska	29.82
6	New Jersey	44.89	31	Arizona	29.76
7	Minnesota	44.11	32	Maryland	29.31
8	New York	43.14	33	Indiana	27.95
9	New Hampshire	41.59	34	Maine	27.58
10	Idaho	40.57	35	Nevada	27.10
11	ILLINOIS	39.22	36	West Virginia	24.41
12	North Dakota	38.84	37	Missouri	24.02
13	Oregon	38.65	38	Georgia	23.70
14	Michigan	38.29	39	Delaware	23.14
15	Utah	37.51	40	Louisiana	21.92
16	Wyoming	36.85	41	Virginia	20.62
17	Kansas	36.41	42	Kentucky	20.20
18	Iowa	36.23	43	North Carolina	19.67
19	Rhode Island	36.05	44	Tennessee	18.91
20	Montana	33.58	45	Texas	17.01
21	Hawaii	33.50	46	Florida	16.50
22	South Dakota	33.40	47	Arkansas	15.17
23	Colorado	33.19	48	South Carolina	14.43
24	Alaska	32.71	49	Mississippi	10.69
25	Ohio	32.49	50	Alabama	8.93
				All States	29.04

SOURCE: Social Security Bulletin, April, 1960.

CHART 3

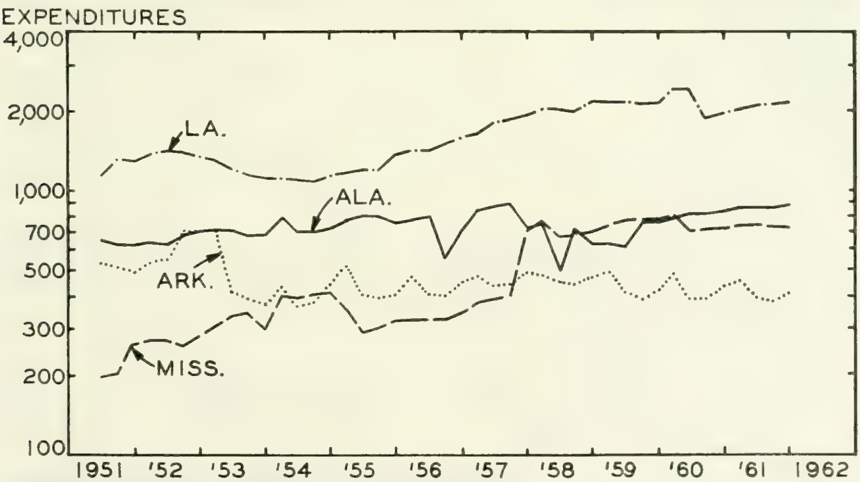
Monthly Expenditure Trends, Aid to Dependent Children,
Industrial States and U. S.



SOURCE: Social Security Bulletin. Data plotted quarterly.

CHART 4

Monthly Expenditure Trends, Aid to Dependent Children, Southern States



SOURCE: Social Security Bulletin. Data plotted quarterly.

termine the level of a state's spending for public assistance purposes. In a recent study the writer was able to show that income, population density, and urbanization of a state are closely correlated with per capita governmental spending for most functions.[28] The method was least satisfactory in

[28] Glenn W. Fisher, "Determinants of State and Local Government Expenditures: A Preliminary Analysis," *National Tax Journal*, December, 1961, pp. 349-355.

the welfare field. A more detailed, but still uncompleted, analysis of the determinants of pubic assistance expenditure is producing more satisfactory results. In this analysis, recipient rates and average payments for each welfare program are analyzed separately and seven independent variables are used. A multiple correlation coefficient of .69 is obtained when these seven variables are correlated with the 1960 ADC recipient rates of the fifty states. Only three of the independent variables are of much significance. They are:[29]

Percent of population living in urban places (+ .33)
Percent of adult population not employed (+ .52)
Percent of families and unrelated individuals with incomes under $2,000 (+ .32)

The number after each variable in the list above is the standardized regression coefficient which indicates the relative importance of the variable. The plus signs indicate that the independent variables and the recipient rate vary in the same direction. A minus sign would indicate that a high value of the independent variable is associated with a low recipient rate.

These results are not surprising. It is generally recognized that high ADC recipient rates are associated with urbanization, poverty, and low levels of employment.

One advantage of the method used here is that it makes it possible to compare recipient rates of the various states after taking account of these variables. This is done by using the regression equation to compute the "expected" or "predicted" value and comparing this value with the actual value.[30]

The "expected" recipient rate for Illinois computed from the regression equation is 3,390 recipients per 100,000 persons under 18 while the actual rate was 4,221.[31]

The same methods and the same independent variables were used to analyze the variation in the average payment to ADC recipients. This time the coefficient of multiple correlation was .83. The independent variables which were most important were:

Population per square mile (+ .22)
Percent of population with less than 5 years schooling (— .41)
Percent of families and unrelated individuals with less than $2,000 annual income (— .27)

---

[29] The other independent variables used and the standardized regression coefficients are:
Population per square mile (— .04)
Percent of population with less than 5 years schooling (+ .07)
Percent of population over 65 receiving OASI benefits (— .02)
Per capita state and local government expenditure for non-welfare purposes (— .07)

[30] It has been common to attempt to achieve much the same result by comparing a given state with a group of similar states. Unfortunately, it is often difficult to determine which states are similar. At best, the choice is arbitrary, and at worst, the choice may be influenced by a desire to support a particular conclusion.

Although the method used here is superior to using a group of states for comparison, there are some weaknesses inherent in the mathematical methods used. For example, it is assumed that the relationship between the independent variables and recipient rates are linear.

[31] The actual rate exceeds the expected rate by .59 of a standard error of estimate. In 12 states the excess is greater.

Per capita state and local government expenditure for non-welfare purposes (+ .20)

The independent variables which emerge as most important are somewhat surprising. It seems reasonable to assume that states with high non-welfare expenditures might be inclined to make relatively high average welfare payments, and that states with a high proportion of low income families would make low payments. On the other hand, no satisfactory explanation for the great importance of the "less than 5 years schooling" variable occurs to the writer.[32]

The average payment estimated for Illinois, when the regression equation is used is $35.33, while the actual payment was $39.22.[33]

These comparisons, like the cruder comparisons in the last section, suggest that the Illinois ADC program is relatively generous.

Old Age Assistance

The federal statutes define "old age assistance" as money payments to, or medical care in behalf of, needy individuals who are 65 years of age or older. Payments to, or for the care of, inmates of a public institution (other than a medical institution) or who is a patient in an institution for tuberculosis or mental disease are specifically excluded.[34]

The administrative provisions are very similar to those of the Aid to Dependent Children program previously discussed. The first nine requirements for approval of an ADC program, listed earlier in this report, are also required for an Old Age Assistance program. In addition, an Old Age Assistance plan must provide for establishing and maintaining standards for institutions in which recipients live. A description of the services (if any) which the state agency makes available to help recipients and applicants to attain self-care must be made available. The age requirement cannot be more than 65 and the residence requirement cannot exclude anyone who has resided in the state for more than five years during the preceding nine years and who has resided in the state for one year immediately preceding application. There can be no citizenship requirement which excludes any citizen of the United States.[35]

The federal grant is equal to 29/35 of the first $35.00 of the average monthly payment, plus one-half of the remainder, up to a maximum of $85.00.[36]

The Old Age Assistance program has been in operation in Illinois since April, 1936. Illinois statutes provide that a person is not eligible for assistance unless he has resided in the state for one year. The residence requirement is lengthened if the applicant comes from a state requiring a

[32] Explanations which involve the relationship between low levels of payment and level of employment or the amount of poverty seem to be ruled out since other variables which better represent these latter factors were included. It is possible that this factor operates on the political rather than the economic side; but, if so, it is by no means clear just how it does operate.

[33] The actual payment exceeds the estimate by .70 of a standard error cf estimate.

[34] 42 U.S.C. Sec. 306 (Suppl. III, 1962).

[35] 42 U.S.C. Sec. 302.

[36] This is the formula that applies to Illinois. The federal percentage of the average payment which exceeds $35.00 is higher in low income states.

longer period of residence. The statutes provide that aid is to be denied to any person who, within the preceding five years, has transferred property for the purpose of qualifying for or increasing the amount of aid. Aid is to be granted only to those who do not have sufficient resources to provide a reasonable subsistence compatible with decency and health, and who do not have responsible relatives able to provide support. An applicant is not required to sell a home which he is occuping in order to be eligible for assistance. The state has a claim against the estate of a deceased recipient for the full amount of assistance paid, but no claim is to be enforced against any real estate while it is occupied as a homestead by a surviving spouse or certain relatives of the recipient. In practice, it appears that a few claims against the estates of deceased recipients are actually enforced.

The amount of assistance is determined in the same general way as is the amount of assistance to dependent children, but there are some significant differences in the wording of the statutes. Prior to 1961, the statutes provided a ceiling on the amount of assistance which could be granted to a recipient of Old Age Assistance. The ceiling was fixed at $65.00 plus an adjustment for changes in the "Consumer Price Index" since January, 1949.[37]

The 1961 legislature repealed the ceiling provision and added the following:[38]

> 502. Sec. 5-2. Amount of Assistance. The Commission shall establish standards which will provide a reasonable subsistence compatible with health and well-being to those eligible for assistance under this Article, including necessary treatment, care, and supplies required because of illness or disability, and rehabilitative or vocational treatment, training or services as provided in Section 2-2.12. The quantity and quality of the items included in the standards established for food, clothing and other needs essential to a reasonable subsistence compatible with health and well-being shall take account of the buying and consumption patterns of self-supporting persons and families of low income, as determined from time to time by the United States Department of Agriculture, the United States Bureau of Labor Statisics, and other nationally recognized research authorities in the fields of nutrition and family living. The items in the standards thus established shall be priced periodically for changes in cost, as provided in Section 2-2.10 of this Code, and allowances adjusted as indicated by the findings of such surveys. Assistance payments shall not be reduced except for changes in (1) cost of items included in the standards, or (2) the expenses of the recipient, or (3) the income or resources available to the recipient.
>
> . . . To effectuate the purposes of this 1961 Amendatory Act in respect to persons who are recipients on its effective date, the Commission shall require the county departments to increase the assistance grants of those recipients whose basic maintenance needs, under standards established by the Commission, are in excess of the maximum

[37] Ill. Rev. Stat. C. 23, Par. 502 (1959).
[38] Ill. Rev. Stat. C. 23, Par. 502.

limitations on basic assistance grants heretofore in effect under this Section. Such increases shall be made effective not later than October 1, 1961. (As amended by HB 780, approved August 10, 1061. *Laws 1961,* p. 3105.)

Recipient Rates. Maximum caseload in the Old Age Assistance program was reached in 1942 when a monthly average of 150,000 persons received assistance.[39] As more and more persons over 65 have become eligible for Old Age and Survivors Insurance Benefits, the number of persons receiving Old Age Assistance has declined. In July, 1962, there were 66,081 persons receiving assistance. Chart 5 shows the recipient rates from July, 1951, to the present. The excellent fit of the logarithmic trend line indicates that the recipient rate has been declining at a nearly constant percentage rate.[40]

The Old Age Assistance rate, unlike the Aid to Dependent Children rate, is lower in Cook County than downstate.[41] On the other hand, there has been a rise in the percentage of recipients living in Cook County. In July, 1951, 38.6 percent of old age recipients lived in Cook County. In 1962, the corresponding percentage was 42.3 percent.

Probably the most significant change in the Old Age Assistance program is the increasing importance of medical assistance. Data on this point are presented below.

Average Payment. The amount of assistance to be given a particular recipient of OAA is computed in the same way as is the amount for recipients of ADC, although separate budget charts are provided for each program. The total personal allowances for a male Old Age Assistance recipient is very close to the allowance for an adult ADC recipient in the same size family, but the allowance for a female OAA recipient is somewhat lower. The 1962 Federal Welfare amendments added language permitting the exclusion of the first $30.00 of earned income of an OAA recipient when computing the other income of recipients. Since 1955, the Illinois statutes have contained provisions authorizing the exclusion of as much as $50.00 if permitted by federal law.

The average payment has risen from $48.82 in July, 1951, to $82.88 in July, 1962. The largest single factor in this rise has been the rapid rise in the importance of vendor payments. This, in turn, reflects both the rapid rise of prices of medical services which has occurred during this period and the increasing extent to which OAA recipients are persons who have some income, but who depend upon OAA for medical attention. It should also

[39] Illinois Public Aid Commission, Exhibit N-1 (mimeographed), November 10, 1960.
[40] The trend line was fitted to annual data. Actual recipient rates are plotted monthly.
[41] Because of the difficulty of obtaining population estimates by age groups for areas smaller than a state, recipient rates for Cook County and downstate have not been computed on a monthly basis for this report. Computations based upon 1950 and 1960 Census figures are as follows:

	JULY 1951	MAY 1962
Downstate	171	74
Cook	100	61

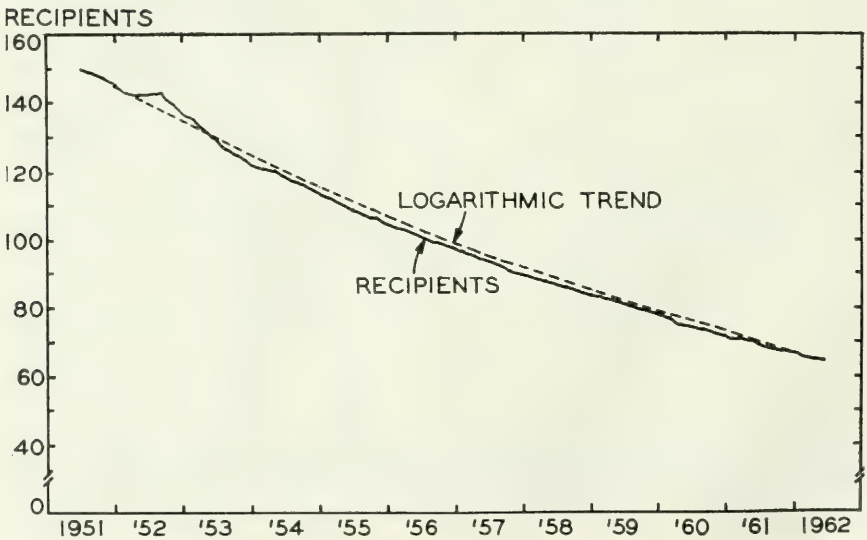
be noted that vendor payment data for July, 1951, are not strictly comparable with that of later years because the cost of hospitalization of OAA recipients at Cook County Hospital was not paid by the Public Aid Commission until legislation passed in 1951 became effective.

The Medical Payments Fund. It is necessary to understand certain changes in the method of paying and accounting for medical payments in order to correctly interpret Chart 6. Prior to Ocotober, 1950, the federal government would not match funds when payments were made directly to hospitals or other medical vendors, although some vendor payments were made in Illinois prior to that time. Other types of medical care were provided for through cash grants to recipients. Some of the variation in 1952 was due to a backlog of unpaid bills due to administrative procedure.

In August, 1953, still another change in the method of handling medical payments occurred. The new system, which is still in effect, involves a medical pool, or medical "insurance" fund. At the time the fund was established, there was a limitation upon the monthly payment to an individual recipient which the federal government would match. This meant that in the event of a serious illness the vendor payment made by the state would be in excess of the maximum and that no federal matching funds would be available for the amount of the excess. By establishing a "medical insurance" or pooled fund and paying a monthly "premium" or medical capitation payment on

CHART 5

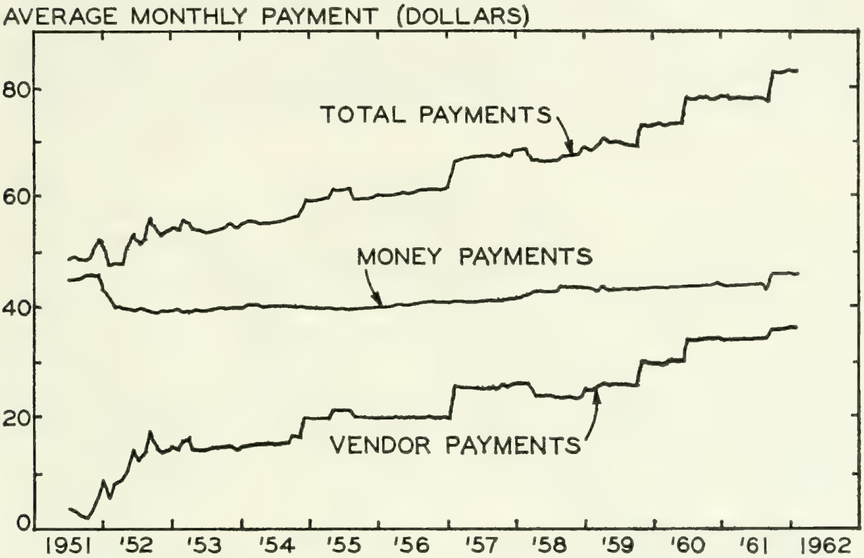
Number of Old Age Assistance Recipients
Per 1,000 Population Aged 65 and Over



SOURCE: See Appendix.

CHART 6

Average Monthly Money and Vendor Payments, Old Age Assistance



SOURCE: See Appendix.

behalf of each recipient of Old Age Assistance, Illinois was able to increase the amount of federal matching funds obtained.[42]

Since the pooled fund has been in operation, monthly expenditure reports of the Illinois Public Aid Commission have been based upon the money payments to the recipients plus payments into the pooled funds. Since actual payments made from the pooled fund may vary somewhat from the amounts paid into the fund, adjustments must be made in the amount of the capitation payments from time to time. This explains the "stairstep" appearance of the vendor payment line in Chart 6, which in turn, is reflected in the total payments line. The Illinois Public Aid Commission does report medical vendor obligations incurred on a monthly basis, but there is a lag of some seven months in reporting these figures in order to allow all the bills to come in. Substituting these figures for those used in Chart 6 would tend to smooth out the "stairsteps" and also to introduce some smaller irregularities due to seasonal or irregular patterns of medical expenditures.

Medical Obligations. Table 12 shows the average obligation per recipient, by type of service incurred in December, 1953[43] and in the most recently available month, October, 1961.

---

[42] Zane M. Polemis, "The Medical Payment Fund," *Public Aid in Illinois*, December, 1961, pp. 12-15.

[43] Although the "pooled fund" system went into effect in August, 1953, obligation data is not available for months prior to December of that year.

This table indicates that the cost of the medical services rendered the average recipient has more than doubled in less than eight years. The relative importance of the various types of services rendered has not changed greatly in this period. Nursing home care has declined slightly in importance and now accounts for one-half of all medical vendor payments. Payments to hospitals account for slightly more than one-fourth of the total, with physicians' services, drugs, and other types of medical services accounting for the remainder.

The increase in medical payments undoubtedly reflects a rise both in the quantity of medical services rendered and in the costs of services, but it is not possible to determine the exact relative importance of the two factors. During the period covered by Table 12, the medical price component of the Consumers Price Index has risen by 31 percent. This index, however, cannot be considered a very good measure of the cost of the kinds of medical services provided to recipients of Old Age Assistance. It is obvious, for example, that nursing home care is a much less important component of the Consumer Price Index than would be necessary in an index compiled to measure the cost of the medical services provided recipients of Old Age Assistance.

Interstate Comparisons. In fiscal year 1960, thirty-eight states had a higher Old Age Assistance recipient rate than did Illinois. The ranking of all fifty states is shown in Table 13.

The Illinois average monthly Old Age Assistance payment in January, 1960, was exceeded in only 15 states. The ranking of all states is shown in Table 14. If the states are ranked according to money payments only, Illinois drops to 40th place, indicating that the average medical vendor payment in Illinois is much larger than in most other states.

Charts 7 and 8 show the trends in monthly expenditure for Old Age Assistance for the year 1951-1962. During this period, Illinois expenditures

TABLE 12

Medical Obligations Incurred per Old Age Assistance Recipient, by Type of Service, December, 1953 and October, 1961

	December, 1953		October, 1961	
	Amount	Percent	Amount	Percent
Nursing Home Care	$ 8.62	54.5	$17.60	50.6
Physicians' Services	1.61	10.2	2.46	7.1
Drugs	1.24	7.8	4.08	11.7
Hospitals	3.93	24.8	9.22	26.5
Other	.42	2.7	1.45	4.2
TOTAL	$15.82	100.0	$34.81	100.0

SOURCE: *Public Aid in Illinois.*

has been virtually stable, although expenditure for the U. S. as a whole has risen. Among the industrial states for which data are given, California and Ohio have shown the most consistent rate of increase. Expenditure in Michigan and Illinois has been very stable. New York expenditure rose substantially until the early months of 1961 when a large scale transfer of recipients to the Assistance to the Medically Indigent Aged got underway. Expenditure in all of the southern states for which data are given has increased substantially more than in the United States as a whole.

TABLE 13

Old Age Assistance

Average Number of Recipients Per 100,000 Population

Aged 65 and Over, 1960 Fiscal Year

Rank	State	No. of Recipients	Rank	State	No. of Recipients
1	Louisiana	51,641	26	South Dakota	12,651
2	Mississippi	42,273	27	Florida	12,631
3	Alabama	38,057	28	North Dakota	12,476
4	Oklahoma	36,385	29	Kansas	12,046
5	Georgia	33,511	30	West Virginia	11,528
6	Colorado	32,463	31	Maine	11,129
7	Texas	29,836	32	Montana	10,796
8	Arkansas	28,628	33	Iowa	10,676
9	Alaska	26,959	34	Ohio	9,979
10	Missouri	23,337	35	Oregon	9,947
11	South Carolina	21,941	36	Michigan	9,842
12	New Mexico	20,798	37	Nebraska	9,322
13	Kentucky	19,409	38	Wisconsin	8,932
14	California	18,729	39	ILLINOIS	7,745
15	Tennessee	18,063	40	Rhode Island	7,614
16	Washington	17,981	41	New Hampshire	7,323
17	North Carolina	15,785	42	Indiana	6,371
18	Arizona	15,448	43	Connecticut	6,128
19	Nevada	14,472	44	Virginia	5,155
20	Massachusetts	14,069	45	Hawaii	5,044
21	Minnesota	13,397	46	New York	4,963
22	Utah	13,355	47	Pennsylvania	4,452
23	Vermont	13,100	48	Maryland	4,211
24	Wyoming	12,973	49	Delaware	3,782
25	Idaho	12,747	50	New Jersey	3,357
				All States	14,212

SOURCE: Computed from Social Security Bulletin and 1960 U.S. Census Reports.

TABLE 14

Old Age Assistance

Average Monthly Payment, January, 1960

Rank	State	Payment	Rank	State	Payment
1	Connecticut	$110.84	26	Utah	$ 66.51
2	New York	105.97	27	Louisiana	66.11
3	Massachusetts	100.06	28	Alaska	64.22
4	Colorado	99.13	29	Montana	63.84
5	California	90.73	30	Maine	63.78
6	New Jersey	88.24	31	Hawaii	61.98
7	Minnesota	85.90	32	Arizona	61.89
8	North Dakota	85.01	33	Indiana	61.04
9	Washington	83.56	34	Maryland	60.49
10	Oklahoma	82.87	35	South Dakota	60.43
11	Wisconsin	79.50	36	Missouri	59.49
12	Kansas	78.66	37	Vermont	57.67
13	New Hampshire	78.05	38	Florida	55.29
14	Rhode Island	77.77	39	Texas	52.98
15	Oregon	77.44	40	Delaware	49.33
16	ILLINOIS	73.53	41	Alabama	48.17
17	Iowa	73.51	42	Arkansas	47.76
18	Michigan	71.81	43	Georgia	47.26
19	Wyoming	70.79	44	Kentucky	44.89
20	Ohio	70.57	45	Virginia	43.56
21	Nevada	70.34	46	Tennessee	41.28
22	Nebraska	69.35	47	North Carolina	40.73
23	Pennsylvania	68.20	48	South Carolina	39.52
24	New Mexico	67.37	49	West Virginia	36.97
25	Idaho	66.79	50	Mississippi	29.83
				All States	66.63

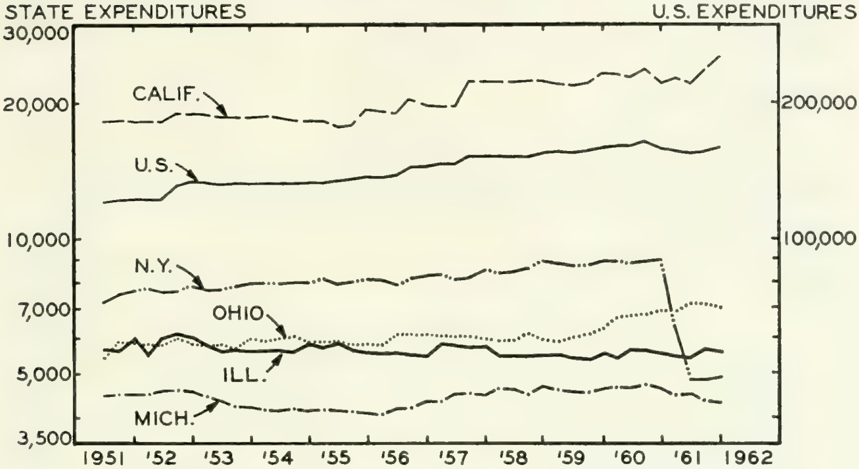
SOURCE: *Social Security Bulletin,* April 1960.

Regression Analysis. Multiple correlation analysis indicates that high OAA recipient rates are associated with urbanization, with a high percentage of low income families, and with a low OASI recipient rate.[44] The coefficient of multiple correlation is .87. The "expected" Illinois recipient rate, computed from the regression equation, is 10,916 per 100,000 population.

[44] The standardized regression coefficients are:
Population per square mile (.00)
Percent of population living in urban places (+ .27)
Percent of adult population with less than 5 years schooling (— .06)
Percent of adult population not employed (+ .15)
Percent of families and unrelated individuals with incomes under $2,000 (+ .51)
Percent of population over 65 receiving OASI (— .60)
Per capita government expenditure for non-welfare purposes (+ .08)

CHART 7

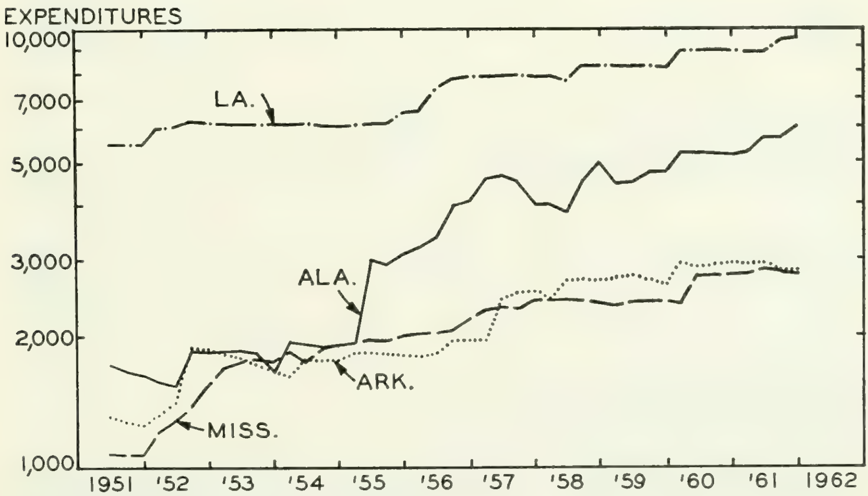
Monthly Expenditure Trends, Old Age Assistance,
Industrial States and U.S.



SOURCE: Social Security Bulletin. Data plotted quarterly.

CHART 8

Monthly Expenditure Trends, Old Age
Assistance, Southern States



SOURCE: Social Security Bulletin. Data plotted quarterly.

The actual rate of 7,745 persons is .59 of a standard error of estimate less than the "expected" rate.

There is a considerable amount of association between five of the seven variables and the average payment per recipient.[45]

The "expected payment in Illinois in 1960 is $76.59, while the actual figure was $73.53, which is .29 of a standard error of estimate less than the "expected" value.

Disability Assistance

Disability Assistance in Illinois was initiated in December, 1950. Amendments to the Social Security Act earlier in the year had provided matching federal funds to states for the care of needy persons with serious mental or physical handicaps.[46]

The Illinois statutes state that a person is totally and permanently disabled:

> . . . if he has a physical or mental impairment, disease or loss which is of a permanent nature and which substantially impairs his ability to perform labor or services or to engage in useful occupations for which he is qualified, as determined by rule and regulation of the commission. The existence of a permanent and total disability shall be determined by technically competent persons designated by the Executive Secretary of the Commission on the basis of medical, social and vocational reports certified by the County Department in the manner and form required by the Commission.[47]

To be eligible for assistance, a disabled person must be between the ages of 18 and 64 inclusive, must have resided in the state for at least one year, and must not be a patient in a public institution.

Administrative provisions generally parallel those of the other federally-aided programs. Prior to 1961, payment maxima identical to those which applied to Old Age Assistance, applied to the Disability Assistance program. The 1961 legislature removed those maxima and added language concerning the standards to be used in determining amounts of payment which is identical to that quoted in the OAA section of this report.

Recipient Rates. The growth in the Disability Assistance recipient rate is shown in Chart 9. Assistance programs normally do not reach their peak until several years after their initiation. This apparently results from the fact that it takes time to organize the program and for potential recipients to become aware of the fact that they may be eligible for aid. The growth of the Disability Assistance program in Illinois from 1951 to 1955 reflects

[45] The standardized regression coefficients are:
Population per square mile (+ .35)
Percent of population living in urban places (+ .28)
Percent of population with less than 5 years schooling (— .53)
Percent of adult population not employed (.00)
Percent of families and unrelated individuals with incomes under $2,000 (+ .04)
Percent of population over 65 receiving OASI (— .22)
Per capita government expenditure for non-welfare purposes (+ .27)

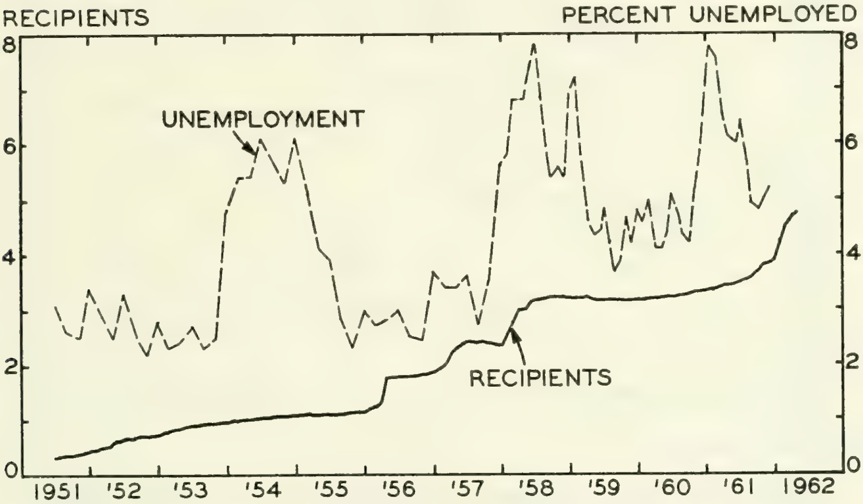
[46] Illinois Public Aid Commission, *The Disability Assistance Program in Illinois* (mimeographed), Exhibit M, May 12, 1961.

[47] Ill. Rev. Stat. Ch. 23, Par. 752.

this normal growth pattern. The 1955 legislature liberalized the definition of permanent and total disability by replacing the words "constitutes a total disability with respect to his ability to perform labor . . ." with the present reference to *substantially impairing* ability to perform labor.[48] This liberalization apparently was a major factor in the rapid increase in the recipient rate which occurred early in 1956. The rapid increase in the first half of 1957 resulted from the transfer of a large number of cases from the General Assistance program to the Disability Assistance program. After the merger

CHART 9

Number of Disability Assistance Recipients Per 1,000 Population Aged 18-64 and Percent of Civilian Labor Force Unemployed



SOURCE: See Appendix.

of the Cook County and the Chicago welfare departments early in 1958, there was an even larger-scale transfer of recipients from General Assistance to Disability Assistance. Still a third wave of transfers occurred early in 1962.[49]

The rapid increase in the recipient rate in 1962 was due largely to the transfer of cases from General Assistance to Disability Assistance in Cook County.[50]

Average Payments. Average monthly money and vendor payments are shown in Chart 10. The fluctuations during the 1951-1953 period are the result both of the newness of the Disability program and the changes in the method of accounting for vendor payments which were discussed in the

---

[48] Ill. Laws 1955, at 506.

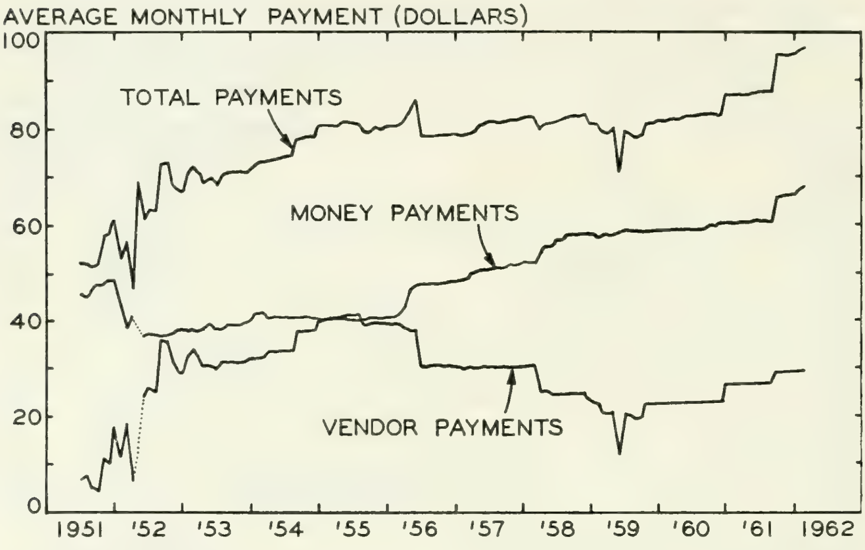
[49] Illinois Public Aid Commission records of new case openings and transfers from other programs clearly show these "waves" of transfers.

[50] *Public Aid in Illinois*, May, 1962, pp. 26-27.

section on Old Age Assistance. The sharp drop in vendor payments in 1956 is related to the liberalization of the definition of disability by the 1955 legislature. Those persons who became eligible for the program as a result of the new definition were less in need of medical care, and average vendor payments per case dropped sharply. The sharp one-month drop in reported

CHART 10

Average Monthly Money and Vendor Payments, Disability Assistance



SOURCE: See Appendix.

payments in June, 1959, resulted from a cut in monthly capitation payments for the last month of the biennium as a result of a shortage of appropriated funds.

Interstate Comparisons. In fiscal year 1960, the Illinois recipient rate ranked 29th among the 46 state rates shown in Table 15. Four states did not have Disability Assistance programs. The average payment in January, 1960, of $82.25 was exceeded in thirteen states. Table 16 shows the ranking of all states. Charts 11 and 12 indicate rather varied expenditure trends in the southern and industrial states for which data is shown. A rapid rise in the early years of the program seems to be characteristic but there is considerable variation in the length of this phase and the extent to which the recipient rate levels off.

Blind Assistance

A blind relief act was enacted in Illinois in 1903. At first, the program was financed entirely by the counties. In later years one-half of of the cost was paid by the state. Although the Social Security Act of 1935 provided

matching funds for approved Blind Assistance programs, Illinois continued with the older program until 1943.[51]

The number of persons receiving Blind Assistance began declining even before the initiation of the federally-aided program. In 1938 there were

TABLE 15

Disability Assistance

Average Number of Recipients Per 100,000 Population Aged 18-64, 1960 Fiscal Year

Rank	State	No. of Recipients	Rank	State	No. of Recipients
1	Georgia	961	26	Maryland	345
2	Mississippi	959	27	South Dakota	324
3	Louisiana	936	28	Florida	323
4	California	883	29	ILLINOIS	319
5	Arkansas	769	30	Wyoming	302
6	North Carolina	742	31	Idaho	299
6	West Virginia	742	32	Hawaii	298
8	Oklahoma	723	33	Virginia	278
9	Alabama	722	34	Pennsylvania	262
10	Missouri	660	35	Nebraska	227
11	South Carolina	625	36	Ohio	215
12	Colorado	592	37	North Dakota	191
13	Rhode Island	571	38	New Jersey	183
14	Oregon	511	39	Connecticut	153
15	Utah	508	40	Delaware	149
16	Kentucky	489	41	Iowa	147
17	New Mexico	480	42	Minnesota	130
18	Tennessee	441	43	New Hampshire	126
19	Vermont	422	44	Texas	111
19	Washington	422	45	Michigan	106
21	Montana	395	45	Wisconsin	106
22	Maine	394		Alaska	—
23	New York	379		Arizona	—
24	Kansas	360		Indiana	—
25	Massachusetts	353		Nevada	—

SOURCE: Computed from Socal Security Bulletin and 1960 U.S. Census Reports.

8,500 persons receiving assistance under the state-county program. By September, 1943, the number had declined to 6,800. As indicated in Table 17, the number of recipients has since declined to less than 3,000.

[51] Illinois Public Aid Commission, *The Blind Assistance Program in Illinois* (mimeographed), Exhibit P, July 10, 1961.

Somewhat less emphasis is placed upon the need of a recipient in the program of Blind Assistance than is true of other federally-aided programs. As the result of the 1950 amendments to the Social Security Act, the first $50.00 of earned income was disregarded in computing the amount of assistance needed. Since October, 1960, the first $85.00 of earned income, plus one-half of the amount in excess of $85.00 per month has been disregarded.

As indicated in Table 17, the increase in average monthly payments has more than offset the decline in the number of recipients so that the total amount of Blind Assistance has risen slightly in the ten year period.

The recipient rates for Blind Assistance varies greatly from state to

TABLE 16

Disability Assistance

Average Monthly Payment, January, 1960

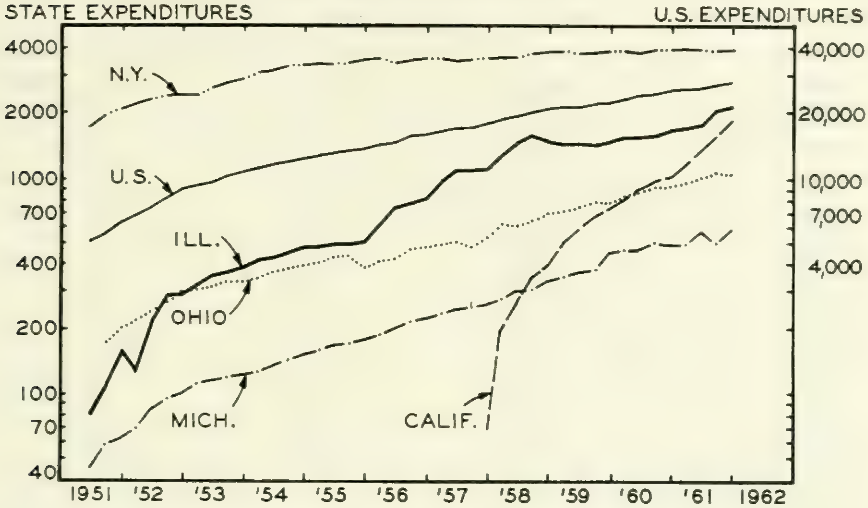
Rank	State	Payment	Rank	State	Payment
1	Connecticut	$130.51	26	Maryland	$ 65.16
2	Massachusetts	114.44	27	South Dakota	62.45
3	New York	102.78	28	Florida	62.24
4	Wisconsin	102.60	29	Missouri	61.51
5	New Hampshire	93.96	30	Minnesota	61.28
6	Washington	93.76	31	Pennsylvania	61.00
7	North Dakota	93.23	32	Vermont	60.48
8	Oklahoma	93.05	33	Maine	59.52
9	New Jersey	93.04	34	Texas	54.12
10	California	92.05	35	Louisiana	53.77
11	Michigan	86.16	36	Georgia	51.80
12	Oregon	84.52	37	Virginia	49.08
13	Kansas	83.81	38	North Carolina	47.02
14	ILLINOIS	82.25	39	Tennessee	45.64
15	Rhode Island	82.18	40	Kentucky	44.21
16	Hawaii	76.75	41	South Carolina	42.46
17	Utah	74.87	42	West Virginia	41.58
18	Wyoming	71.78	43	Arkansas	35.89
19	Idaho	71.72	44	Alabama	35.47
20	Montana	71.51	45	Mississippi	30.17
21	Nebraska	71.29		Iowa	Not Available
22	Ohio	69.36		Alaska	—
23	Colorado	67.56		Arizona	—
24	Delaware	66.27		Indiana	—
25	New Mexico	65.17		Nevada	—
				All States	64.63

SOURCE: *Social Security Bulletin,* April, 1960.

state. In fiscal year 1960, Mississippi had a rate of 289 recipients per 100,000 population, which was twice the rate of Pennsylvania which had the next highest rate. The Illinois rate of 30 placed the state 33rd and was well below

CHART 11

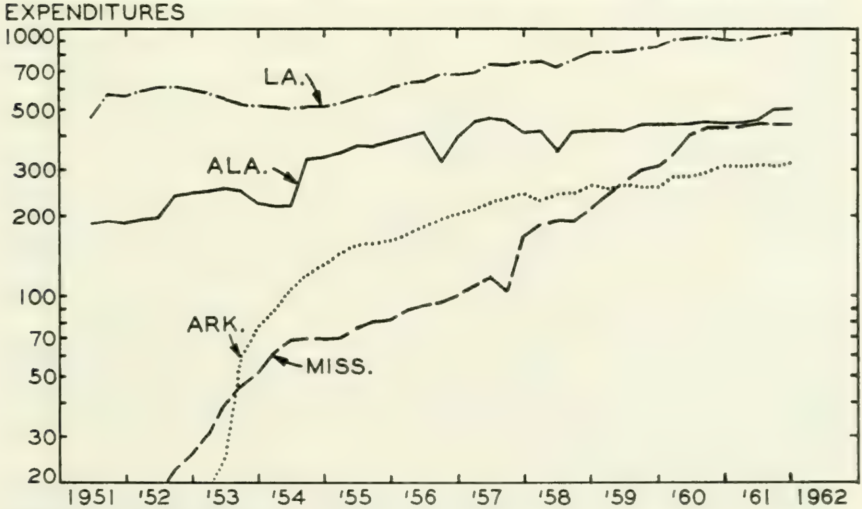
Monthly Expenditure Trends, Disability Assistance, Industrial States and U.S.



SOURCE: Social Security Bulletin. Data plotted quarterly.

CHART 12

Monthly Expenditure Trends, Disability Assistance, Southern States



SOURCE: Social Security Bulletin. Data plotted quarterly.

the all-state average of 59. The average payment in Illinois in January, 1960, was $81.96, an amount which was exceeded in fifteen states. The U.S. average was $72.28.[52]

TABLE 17

Blind Assistance

Amount of Assistance, Number of Recipients and Average Monthly Payments

Fiscal Year	Amount of Assistance (thousands)	Average Number of Recipients	Average Monthly Payment
1952	$2,725	4,119	$55.11
1953	2,855	3,985	59.72
1954	2,734	3,727	61.18
1955	2,760	3,600	63.89
1956	2,821	3,491	67.32
1957	2,844	3,434	69.02
1958	2,904	3,297	73.40
1959	3,000	3,197	78.20
1960	2,961	3,050	80.98
1961	3,004	2,963	84.37

SOURCE: Computed from *Public Aid in Illinois.* Monthly amounts of assistance were rounded to nearest $1,000 before totaling.

General Assistance

Local units of government in Illinois are charged with the responsibility of providing relief for those needy persons who do not quality for the categorical (federally-aided) programs.[53] In the counties which are under the township form of organization, the township supervisor is ex-officio supervisor of General Assistance. In counties having the commission form of government, the county board designates a supervisor of General Assistance for the county. In Cook County, the Department of Public Aid supervises General Assistance.

The local unit may receive state funds if it levies a tax for General Assistance purposes of at least one-mill per dollar of assessed valuation. The state pays all costs in excess of the amount raised by the local levy. The Illinois Public Aid Commission assumes general supervision over the administration of the General Assistance program in units receiving state funds.

At any given time, a relatively small number of the 1,455 units administering General Assistance receives state funds; although the majority of General Assistance cases are found in counties which do receive state funds.[54]

[52] Computed from *Social Security Bulletin.*
[53] Ill. Rev. Stat., C. 23, Par. 401.
[54] In April, 1962, there were 35,205 General Assistance cases in local units receiving state funds, wh'le only, 8,800 cases were receiving aid in non-receiving units. *Public Aid in Illinois,* June, 1962, p. 27.

To be eligible for General Assistance, the applicant must have lived in the state for at least one year and in the local unit for at least six months. Emergency assistance may be given pending return of the needy person to his legal residence. The recipient must not be eligible for assistance under the categorical programs and all employable adults must be registered for employment with the Illinois State Employment Service.

Units which are supervised by the Illinois Public Aid Commission must grant assistance on the basis of a uniform budget which has been approved by the Illinois Public Aid Commission.[55] The Illinois Public Aid Commission will not approve a budget which is in excess of those used in the categorical programs, but many local units receive approval of budget standards which are lower.[56] Supervisors of General Assistance for units not receiving state funds are directed by law to provide grants sufficient, when added to other available resources, to provide a reasonable subsistence compatible with health and well-being. Determination of the amount of assistance necessary to meet this standard is left entirely to the individual supervisor.

Recipients of General Assistance may receive either cash assistance or disbursing orders for goods and services. In Cook County, cash grants are used, but disbursing orders are almost universal in the remainder of the state.[57]

Recipient Rates. The number of persons receiving General Assistance fluctuates markedly in response to seasonal and cyclical factors. Chart 13 shows the fluctuations which have occurred in the recipient rate since 1951. It is obvious that there is a direct connection between the number of persons receiving assistance and the level of employment in the state. Because of the possibility that some recipients of ADC-U would have received General Assistance had ADC-U not been in operation, the number of persons receiving both ADC-U and General Assistance is shown for the months after May, 1961.

Average Payment. The average monthly payment to General Assistance recipients fluctuates considerably, but is generally well below the average payment to Old Age Assistance or Disability Assistance recipients and somewhat higher than ADC payments. Average family size is a major factor in explaining these differences. Personal allowances are smaller for children and are reduced as the size of the family increases. Further, rental costs, per person, are apt to be smaller in a large family.

Variations in family size also do much to explain the rather marked fluctuations in the average payments to General Assistance recipients. During periods of high employment, General Assistance recipients tend to be "hard core" cases which include many single persons and thus the average payment is high. During periods of recession many cases added to the rolls

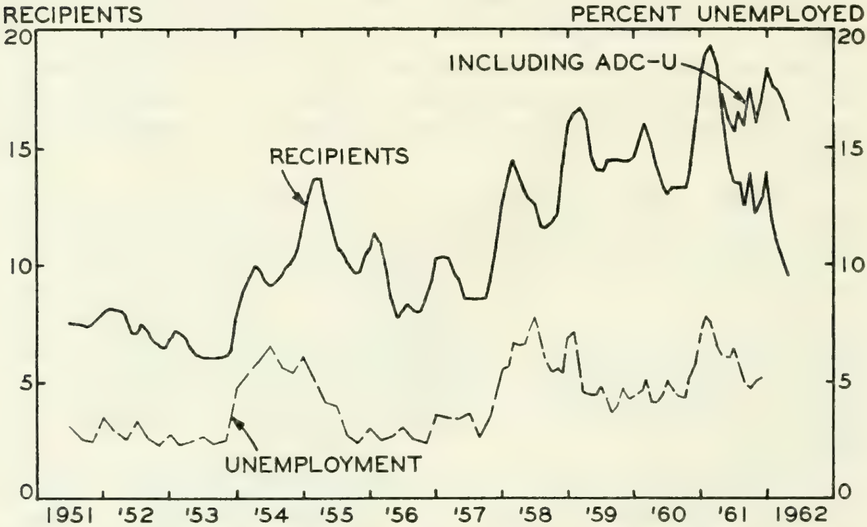
[55] Ill. Rev. Stat., C. 23, Par. 426.
[56] Commission on Public Aid and Assistance, *New Horizons in Public Assistance in Illinois*, June, 1959, pp. 79-80.
[57] *Ibid.*, p. 79.

are families who receive less assistance, per person, than do single persons. The existence of the ADC-U program may cause some change in this pattern, but more time must elapse before the results can be judged.

Interstate Comparisons. Great care must be exercised in using the available statistics to compare General Assistance programs in the various states. Because General Assistance is not a federally-aided program, there is a great deal more state to state variation in the program. The U.S. Bureau of Public Assistance has provided a definition of General Assistance to be used by the states in compiling the statistics which are published in the Social Security Bulletin. Because of the variation in the way the needs

CHART 13

Number of General Assistance Recipients Per 1,000 Population and Percent of Civilian Labor Force Unemployed



SOURCE: See Appendix.

of needy persons not eligible for the federally-aided programs are handled in the various states, the reported figures still may not give a completely accurate picture. General Assistance statistics for 1960 were reported on a "per case" rather than a per recipient basis. Vendor payments were excluded.

The 1960 data indicate that the General Assistance caseload rate in Illinois was higher in 1960 than in any other state and that only two states made higher average payments. State rankings are shown in Tables 18 and 19. Data for June, 1962, indicate that the "recipient rate" in Illinois was fifth highest in that month.

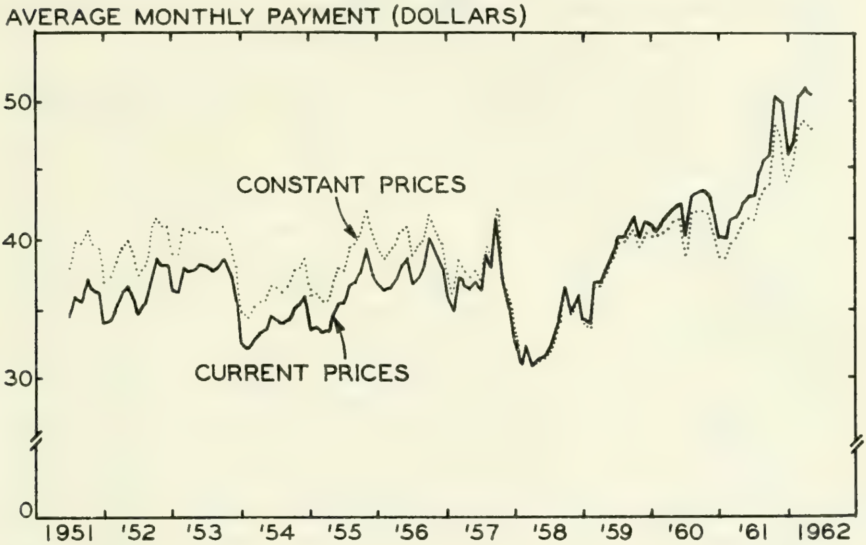
Charts 15 and 16 indicate that General Assistance expenditure trends in Illinois are roughly similar to those in the other industrial states, with

which comparison is made. In some of the Southern states which have been used for comparative purposes in this study, the expenditure fluctuates very widely around a very low level. In these circumstances trend comparisons are virtually meaningless, thus no chart of expenditures in these states is presented.

Multiple Regression Analysis. Multiple regression analysis of the number of cases receiving General Assistance does not produce entirely satisfactory results. The coefficient of multiple correlation is .61 but the standard

CHART 14

Average Monthly Payments, General Assistance



SOURCE: See Appendix.

error is so large that "expected" caseload rates differ greatly from the actual rates in many states. The "expected" caseload in Illinois is 201 per 100,000 population whereas the actual caseload is over twice this figure. Only in Louisiana does the actual caseload exceed the "expected" caseload by a larger amount.

Geographic Variations Within Illinois

There are wide differences in the level and pattern of public assistance expenditure in Illinois. To illustrate these differences, five groups of Illinois counties, representing different geographic and economic characteristics, were chosen.

Three of the five groups are made up of countries which are predominantly urban. Cook County makes up the first of these "groups." It contains roughly one-half of the population of the state. It is an area of

moderately increasing population, very high population density, and is almost entirely urbanized. Per capita income is almost 50 percent above the national average.

Four counties surrounding Cook County make up the second group and have been designated as the Northeastern Metropolitan counties. These counties, Lake, Kane, DuPage, and Will, contain very rapidly growing suburban areas and all are high income counties.

The third group of urban counties is made up of eight counties which

TABLE 18

General Assistance

Average Number of Cases per 100,000 Population, 1960 Fiscal Year (Excludes Cases Receiving Vendor Payments Only)

Rank	State	No. of Cases	Rank	State	No. of Cases
1	ILLINOIS	464	26	New Jersey†	158
2	Indiana†	446	27	Iowa	148
3	Michigan	414	28	New Hampshire	138
4	Washington	381	29	Wyoming	136
5	Delaware	378	30	West Virginia	130
6	Ohio	376	31	Kansas	109
7	Montana	353	32	Nevada	99
8	Rhode Island	351	33	Maryland	93
9	Pennsylvania	333	34	Alaska	90
10	Vermont‡	327	34	Colorado	90
11	Oklahoma	318	34	Texas‡	90
12	Louisiana	269	37	North Dakota	86
13	Minnesota	268	38	Nebraska	84
14	Maine	265	39	Kentucky	73
15	Arizona	247	40	New Mexico	61
16	Utah	237	41	South Dakota	59
17	California	224	41	Tennessee	59
18	New York†	221	43	South Carolina	58
19	Oregon	220	44	Georgia	57
20	Missouri	199	45	Virginia	54
21	Wisconsin	196	46	Mississippi	51
22	Connecticut*	183	47	North Carolina	47
22	Florida*	183	48	Arkansas	19
22	Hawaii	183	49	Alabama	3
25	Massachusetts	163	50	Idaho	Not Available
				All States	223

SOURCE: Computed from Social Security Bulletin and 1960 U.S. Census Reports.
*Partly estimated.
†Includes cases receiving medical care only.
‡Estimate based on sample of local jurisdictions.

TABLE 19

General Assistance

Average Monthly Payment per Case, January 1960

(Excludes Vendor Payments)

Rank	State	Payment	Rank	State	Payment
1	New Jersey†	$101.36	26	Louisiana	$ 48.78
2	New York	96.66	27	Arizona	45.50
3	ILLINOIS	92.64	28	Nebraska	44.32
4	Michigan	90.64	29	Maine	43.97
5	Wisconsin	82.65	30	Virginia	42.70
6	Utah	78.89	31	New Mexico	41.80
7	Minnesota	77.16	32	Indiana†	40.24
8	Washington	75.39	33	Iowa	39.68
9	Pennsylvania	74.96	34	Nevada	37.79
10	Hawaii	74.69	35	South Dakota	36.78
11	Ohio	73.68	36	Montana	32.88
12	Rhode Island	72.58	37	West Virginia	31.48
13	Connecticut*	72.21	38	South Carolina	30.77
14	Massachusetts	69.36	39	Kentucky	30.29
15	Delaware	64.84	40	Georgia	24.56
16	Kansas	64.54	41	North Carolina	23.25
17	Maryland	64.20	42	Tennessee	17.02
18	Wyoming	62.89	43	Mississippi	15.68
19	Oregon	61.24	44	Arkansas	14.74
20	Missouri	59.71	45	Oklahoma	13.34
21	Alaska	58.96	46	Alabama	12.44
22	North Dakota	58.54	47	Florida	Not Available
23	California	55.23	47	Idaho	Not Available
24	New Hampshire	50.59	47	Texas	Not Available
25	Colorado	49.53	47	Vermont	Not Available
				All States	68.51

SOURCE: *Social Security Bulletin*, April, 1960.
*Partly estimated.
†Includes cases receiving medical care only.

either comprise or fall within standard metropolitan statistical areas as defined by the U.S. Census Bureau. All of the major population and industrial centers in downstate Illinois are included.[58] The rate of population growth in these counties is greater than in Cook County, but well below that of the Northeastern Metropolitan counties. Per capita income varies considerably from county to county, but the average is well above the na-

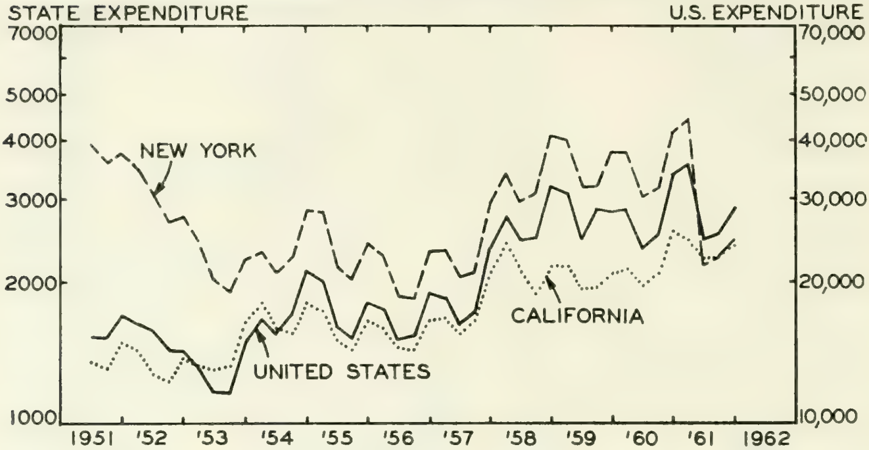
[58] The counties are: Champaign, Macon, Madison, Peoria, Rock Island, St. Clair, Sangamon, Winnebago.

tional average. More than 70 percent of the population in these counties live in urban areas.

The two non-urban county groups have been designated as Southern

CHART 15

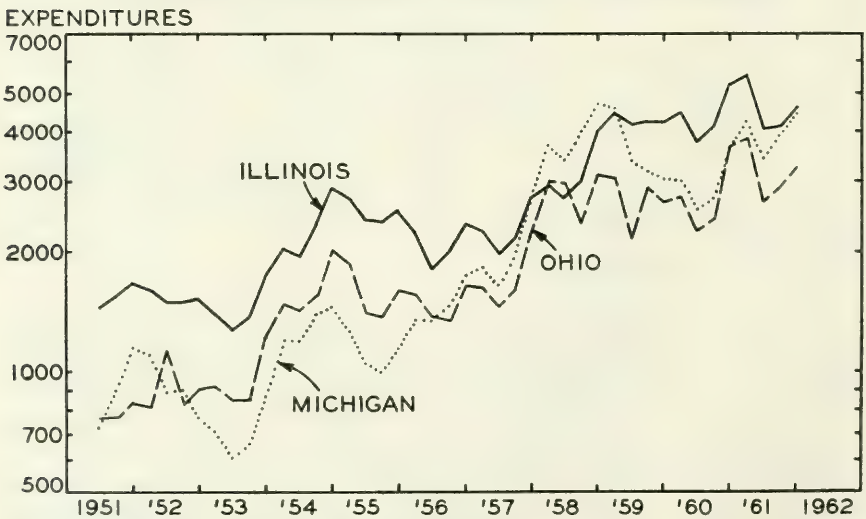
Monthly Expenditure Trends, General Assistance, California, New York and U.S. (Excludes Vendor Payments)



SOURCE: Social Security Bulletin. Data plotted quarterly.

CHART 16

Monthly Expenditure Trends, General Assistance, Three Midwestern Industrial States (Excludes Vendor Payments)



SOURCE: Social Security Bulletin. Data plotted quarterly.

and Agricultural. The Southern group consists of sixteen counties in the extreme southern part of the state.[59] This is an area in which the population lives in small towns and in rural areas. Most of the area is economically depressed. Income is low and population is declining.

TABLE 20

Recipient Rates and Average Monthly Payments, by Program and by County Groups July 1962

Program	Cook	Northeastern Metropolitan	Downstate Metropolitan	Southern	Agricultural
Aid to Dependent Children:					
Recipient Rate	116.5	8.3	73.6	147.2	22.3
Average Payment ..	$ 47.34	$ 38.08	$ 38.68	$ 36.07	$ 38.33
Old Age Assistance:					
Recipient Rate	61.4	22.7	64.3	157.9	78.2
Average Payment ..	$ 88.79	$ 73.94	$ 77.76	$ 78.91	$ 80.84
Disability Assistance:					
Recipient Rate	6.6	.2	3.0	9.1	2.7
Average Payment ..	$105.54	$ 96.30	$ 83.54	$ 76.97	$ 76.63
Blind Assistance:					
Recipient Rate	.3	.1	.3	.9	.3
Average Payment ..	$104.15	$ 73.53	$ 81.36	$ 87.59	$112.90
General Assistance:					
Recipient Rate	8.7	1.9	9.4	15.4	3.4
Average Payment ..	$ 66.96	$ 41.58	$ 39.34	$ 41.24	$ 23.92
Total—All Programs:					
Recipient Rate	56.7	6.9	43.3	90.9	23.2
Average Payment ..	$ 58.57	$ 48.96	$ 46.03	$ 50.11	$ 58.24

SOURCE: Illinois Public Aid Commission and 1960 U.S. Census. Recipient rates are the number of recipients per 1,000 persons in relevant age groups as follows:
Aid to Dependent Children—0-17.
Old Age Assistance—over 65.
Disability Assistance—18-64.
Blind Assistance, General Assistance and All Programs—All Ages.

The Agricultural counties are scattered throughout the central and northern parts of the state.[60] They were chosen because a high proportion of personal income comes from agriculture and because per capita income is relatively high for agricultural counties. Population change in the 1950-60

[59] The Southern counties are: Alexander, Franklin, Gallatin, Hamilton, Hardin, Jackson, Johnson, Massac, Perry, Pope, Pulaski, Randolph, Saline, Union, White, and Williamson.

[60] The Agricultural counties are DeWitt, Edgar, Ford, Henderson, Iroquois, Marshall, Menard, Mercer, Moultrie, Putnam, Stark, and Warren.

period exceeds 5 percent in only one of the twelve counties. This group might be characterized as prosperous, stable, and agricultural.

Recipient rates and average monthly payments for the various programs are shown in Table 20. These data show that there is tremendous variation in recipient rates from group to group. The recipient rate for all programs are substantially higher in the depressed Southern group than in any other group of counties. In contrast, the recipient rates in the Northeastern Metropolitan counties are only a small fraction of the rates in the Southern counties and are lower than in any other group. The relative ranking of these two groups is not surprising in view of the great differences in the social and economic situations which exist.

The ranking of the other three groups of counties also varies in ways which reflect social and economic differences. For example, it is not surprising to find that the Agricultural counties have low recipient rates in all programs except in Old Age Assistance. The relatively high recipient rate in the Old Age Assistance program reflects the fact that the percentage of older persons qualifying for Old Age and Survivors Insurance benefits is lower in agricultural areas. It is of interest to note that the General Assistance recipient rate is slightly higher in the downstate Metropolitan counties than in Cook, although the ADC rate is substantially higher in Cook. The reason for this it not entirely clear, but it may reflect a greater concentration of "chronic" cases of poverty in the large city area.

Guidelines for the Future

The projections of future public assistance expenditure which are reported in this section are extensions of existing trends upon the basis of certain assumed conditions. As such, they can be valuable aids to rational planning. They indicate probable ranges of revenue needs and the probable effects of certain possible developments. On the other hand, projections can be dangerously misleading if caution is not observed in using them. In particular, it is important to note that the projections provided are not intended to be statements of what "ought" to be spent. Neither are they "predictions" in the strict sense of the term.

On the other hand, projections are not useful unless they are based upon assumptions which seem likely to occur or which represent alternatives which are "live" options. There is little point, for example, in assuming that the average payment per recipient in Illinois will be cut to the level paid in Mississippi. Although the Illinois legislature could take such drastic action, there are a host of economic, political, and social factors which make it extremely unlikely.

The general assumptions which underlie the projections are the same as those underlying the economic growth projections in Chapter I. The choice of particular trend lines for specific programs was influenced by the data and analysis of past trends which have been presented in this chapter. Since

this material has been presented at somewhat scattered points, a brief summary analysis of each program is presented in this section.

Blind Assistance. Blind Assistance is one of the two programs for which recipient rates have been declining. This apparently reflects improvements in eye care, as well as the success of programs aimed at making blind persons self-supporting.

Both straight-line and logarithmic trend lines fit 1952-61 recipient rate data well. The straight-line trend, assuming a constant absolute decrease in the recipient rate, falls to zero when extended to 1977. Since it seems unlikely that this will occur, the logarithmic trend line is used to make the projections shown in Table 21. This assumes that the annual percentage decrease will remain constant but that the absolute decrease will decline as the program gets smaller.

TABLE 21

Aid to the Blind Expenditure Projections, 1962-1971

			Annual Expenditures (in thousands of dollars—1961 prices)	
Fiscal Year	Recipient Rate*	Number of Recipients	Based on Constant Average Payment†	Based on Rising Average Payment‡
1962	.28	2,926	$3,180	$3,266
1963	.26	2,782	3,024	3,200
1964	.25	2,712	2,948	3,211
1965	.24	2,634	2,863	3,207
1966	.23	2,599	2,826	3,251
1967	.22	2,530	2,751	3,250
1968	.20	2,350	2,555	3,098
1969	.19	2,261	2,458	3,057
1970	.19	2,289	2,488	3,171
1971	.18	2,232	2,427	3,165

*Number of recipients per 1,000 population.
†$90.60.
‡Rises from $93.02 in 1962 to $118.17 in 1971.

The projected recipient rates were applied to Series II population projections to obtain the projected number of recipients.

Average payments to recipients of Blind Assistance rose fairly steadily from July, 1951, to October, 1961, when a sharp rise occurred because of the change in budget standards. The "high" projections of annual expenditure are based upon the assumption that the trend toward a rising "real" monthly average payment will continue at the same rate as it did before the October 1961 change. In other words, it is assumed that there will not be another sharp increase such as occurred in October, 1961, but that the

upward drift which raised the average payment in the period prior to that time will continue. To implement these assumptions the average payments for the 1953-1961 (fiscal years) period were deflated, using the Consumer Price Index, and a straight-line trend was fitted. This trend line was then extended to 1971 and the amounts were adjusted upward to allow for the October 1961 increase.[61] The resulting figures were then converted from 1957-1959 dollars to 1961 dollars so that they would be compatible with other projections in this study.

The "low" expenditure projections for this program are based upon the assumption that real average payments will not change from the July 1962 level.[62] Although such a stabilization does not appear very likely upon the basis of the historical record, it certainly does not seem impossible. The fact that budget standards have been revised upward and are therefore more adequate, might make it possible to hold the line on any increases other than those required by cost of living increases.

Old Age Assistance. Since 1951, the number of Illinois Old Age Assistance recipients has declined steadily. This is associated with the increasing numbers of persons who receive Old Age and Survivors Insurance or have been able to provide for their old age in other ways. There is almost no association between the recipient rate and the level of unemployment. There is a high level of correlation between the recipient rates in the various states and the independent variables used in the regression analysis. "Per cent of population receiving OASI" and "percent of population with income under $2,000" are the most important independent variables. Within Illinois, the highest recipient rates are in the largely rural, economically depressed Southern area. The second highest rate is found in the Agricultural counties.

The average monthly payments have risen substantially during the period since 1951, due almost entirely to a rise in medical vendor payments. This, in turn, reflects the fact that many old people have Old Age and Survivors Insurance benefits or other resources which are sufficient to meet many of their ordinary needs, but insufficient to meet medical needs. The rising cost of medical care and the increased longevity brought about by medical advances also help explain the fact that 44 percent of Old Age Assistance expenditures are made directly to medical vendors.

Both crude comparisons and regression analysis suggest that Illinois is somewhat less generous in granting Old Age Assistance than are many other states. The virtual stability of expenditure for this program during the last ten years in Illinois contrasts with slowly rising expenditures in many other states.

The regularity of the decline in the OAA recipient rate, shown in

[61] This adjustment was made by determining the difference between the deflated average payment in the three months prior to the increase and the three months following the increase and adding this sum to projected average monthly payments.

[62] Since all projections are presented in terms of constant dollars, this does not rule out increases due to rising prices.

Chart 5, suggests that the logarithmic trend line can be extended into the future with a considerable amount of confidence. The projected recipient rates and the resulting number of recipients are shown in Table 22. This projection is based upon the assumption that Illinois will not undertake a large scale transfer of recipients to the Aid to Medically Indigent Aged (Kerr-Mills) program as New York and a few other states have done.

TABLE 22

Old Age Assistance Expenditure Projections, 1962-1971

			Annual Expenditures (in thousands of dollars—1961 prices)	
Fiscal Year	Recipient Rate*	Number of Recipients	Based on Constant Average Payment†	Based on Rising Average Payment‡
1962	67.2	67,536	$66,337	$64,239
1963	62.2	63,454	62,331	62,058
1964	57.6	59,894	58,834	60,185
1965	53.3	56,732	55,729	58,538
1966	49.4	53,062	52,126	56,167
1967	45.7	50,041	49,151	54,318
1968	42.3	47,387	46,543	52,707
1969	39.2	44,654	43,865	50,869
1970	36.3	42,279	41,530	49,305
1971	33.6	39,445	38,745	47,053

*Number of recipients per 1,000 population aged 65 and over.
†$81.85.
‡Rises from $79.27 in 1962 to$99.40 in 1971.

Since average money payments to recipients, deflated for price changes, varied little from mid-1952 to October, 1961, it is assumed that the same stability will continue during the projection period. The "low" projection is based upon the assumption that the average medical vendor payment will also remain unchanged. In view of the rapid increase in medical vendor payments in the past this must be viewed as a conservative assumption.

The "high" projection is based upon the assumption of a constant average money payment and an average medical vendor payment rising at the same rate (straight-line) as it did in the 1954-1961 period. Largely because of the lack of a suitable price index, medical vendor payments were not deflated before the trend was fitted. The resulting projection is higher than it would be if the trend line had been fitted to a deflated series.

Disability Assistance. Changes in the Disability Assistance recipient rate have been closely associated with changes in legislative policy or administrative action. Following the beginning of the program in December, 1950, the recipient rate increased rapidly for several years and by 1955 had

begun to stabilize. This was interrupted by the rapid increase in 1956 which resulted from legislative liberalization of the definition of disability. Three times since, rapid increases in recipient rates have resulted from a concentrated transfer of cases from the General Assistance program to the federally-aided Disability Assistance program.

It is not clear whether these administrative actions are the "cause" of the increase or whether more fundamental causes are at work. In view of the fact that the three increases all came some months after a sharp rise in unemployment, it is possible that the recipients are persons who became unemployed during a recession and then found that mental or physical handicaps prevented their obtaining work when the unemployment rate failed to return to its pre-recession level.

Average monthly payments have been affected by the change in the character of the program. The rapid decline in average vendor payments in the 1956-1959 period reflects the growing percentage of less severely disabled persons on the recipient rolls. The October 1961 increase in standards is evident in the average payment figures of this program as in all others.

TABLE 23

Disability Assistance Expenditure Projections, 1962-1971

Fiscal Year	Recipient Rate*	Number of Recipients	Annual Expenditure† (in thousands of dollars—1961 prices)
1962	3.92	22,693	$26,418
1963	4.29	25,131	29,251
1964	4.66	27,517	32,036
1965	5.03	30,014	34,940
1966	5.40	32,751	38,128
1967	5.77	35,543	41,376
1968	6.13	38,190	44,457
1969	6.50	41,204	47,966
1970	6.87	44,078	51,308
1971	7.24	47,190	54,935

*Number of recipients per 1,000 population aged 18-64.
†Based upon average monthly payment of $97.01.

In fiscal year 1960, twenty-eight states had higher recipient rates while only 13 had higher average payments. In the last ten years, expenditures in Illinois have grown more rapidly than in any of the states with which comparison is made, except those states which inaugurated the program during the period.

The recipient rate projections shown in Table 23 are based upon a straight-line trend fitted to 1952-1962 fiscal years data. It is possible that much of the increase during the base period represents non-recurring

transfers to the program from General Assistance, but it appears more likely that past trends will continue. Recipient rates are as much as three times as high in some other states as in Illinois. This suggests that the Federal definition of disability will not serve as a ceiling upon the number of persons eligible for the program.

Because of the fluctuations in the average payments which have resulted from the changing character of the program, there is no clear trend in average monthly payments. Deflated average payments were no greater just prior to the October 1961 increase than they were late in 1958. For this reason, Disability Assistance expenditure is projected on the basis of the July 1962 average payment, expressed in 1961 dollars.

General Assistance. General Assistance expenditure is most closely associated with economic factors and more amendable to the usual types of economic analysis than are expenditures for any other type of program. Specifically, there is a close and direct relationship between unemployment rates and the number of General Assistance recipients, although there are a number of reasons why the analysis cannot be as exact as would be desirable.[63] In spite of the difficulties, the relationship between the General Assistance recipient rate and the unemployment rate is easily demonstrated. The relationship can be observed in a rough way in Chart 13. Correlation of the two variables yields a coefficient of .75.[64]

Observation of a scatter diagram of these data reveal that the correlation is reduced by some 'stickiness" of the recipient rates. In other words, recipient rates do not fall as low at the end of a recession as would be expected.

State to state variations in General Assistance programs and weaknesses in the data reported make interstate comparisons somewhat more difficult than in federally-aided programs. On the other hand, it is clear from the available data that both recipient rates and average payments to General Assistance recipients in Illinois are relatively high as compared with other states.

The recipient rate projections shown in Table 24 are based upon the projection of a straight-line trend fitted to 1952-1961 data adjusted for the

[63] The definition of unemployment used in the United States is such that only those actually seeking work are counted as unemployed. It is known, however, that in periods of prolonged unemployment, some persons who would like to work become discouraged and stop seeking work. In time, loss of work habits and job skills may cause these people to become unempolyable. This effect may be especially pronounced in the case of the low-skill, marginal workers who are most apt to be General Assistance recipients.

A second problem with unemployment data is that a single consistent unemployment series for Illinois for the period under analysis is not available. The unemployment data plotted on the various charts throughout this report have been based upon definitions and methods of collection which have varied during the period.

Another problem involved in an attempt to correlate unemployment rates and recipient rates is that the time lag varies. Ordinarily, some time elapses between a person's unemployment and the receipt of public assistance. In the case of a person entitled to unemployment insurance and having a substantial amount of other assets, the lag may be several months. In other cases it may be only a few days. If the average lag were constant it would be easy to adjust for this factor, but unfortunately it varies from recession to recession and appears to be different during an upswing and a downturn.

[64] Recipient rates and percentage of labor force unemployed for every second month from July, 1951, to March, 1961, were correlated. Later data were not included because of the disturbing effect of the ADC-U program.

effect of the ADC-U program. The adjustment consisted of reducing the number of General Assistance recipients by half the projected ADC-U recipients (medium projection). This purely arbitrary adjustment is based upon the assumption that one-half of the persons receiving ADC-U would not have been on the General Assistance rolls if ADC-U were not in existence.

The use of a straight-line trend to project the recipient rate for a program which is so closely associated with the level of employment obviously assumes a continuation of the rising unemployment trend which existed during the base period.

TABLE 24

General Assistance Expenditure Projections, 1962-1971

Fiscal Year	Recipient Rates*	Number of Recipients	Annual Expenditures (in thousands of dollars—1961 prices)		
			Based on $50.00 Average Payment	Based on $55.00 Average Payment	Based on $60.00 Average Payment
1962	14.0	132,477	$ 79,486	$ 87,435	$ 95,383
1963	14.8	143,050	85,830	94,413	102,996
1964	15.6	153,029	91,817	100,999	110,181
1965	16.3	161,780	97,068	106,775	116,482
1966	17.1	174,677	104,806	115,287	125,767
1967	17.9	186,499	111,899	123,089	134,279
1968	18.7	198,366	119,020	130,922	142,824
1969	19.5	209,576	125,746	138,320	150,895
1970	20.2	219,752	131,851	145,036	158,221
1971	21.0	235,389	141,233	155,357	169,480

*Number of recipients per 1,000 population under 65.

Because of the great cyclical fluctuations in the number of General Assistance recipients it is especially important to note that only trends are being projected. No effort is made to project the timing of cyclical variations.

The average monthly payment in the General Assistance program has fluctuated so greatly that there is little point in attempting to project a trend. Instead, arbitrary average payments of $50.00, $55.00, and $60.00 have been assumed.

No projection is made for expenditures from the General Assistance appropriation which are not part of the General Assistance program.[65]

[65] At the present time biennial outlays for the care of medically indigent persons from Chicago and Cicero amount to nearly $13 million. As mentioned earlier in the report, a number of other miscellaneous items have been included in the General Assistance Appropriation in the past.

Aid to Dependent Children. The ADC program is the largest public assistance program in Illinois. It has been characterized by spectacular growth in the last several months. The magnitude of the growth can be seen by noting that in fiscal year 1961, only 28.3 percent of public assistance expenditure (exclusive of administration) was for Aid to Dependent Children. In July, 1962, 50 percent was for this purpose.

Part of the spectacular increase was due to the inauguration of the ADC-U program which was, in turn, a response to the mounting unemployment problem. Undoubtedly, many of the families receiving assistance under the ADC-U program would have received General Assistance if the ADC-U program had not been in operation.

The causes of the increase in the number of ADC cases are especially hard to isolate. The immediate crisis leading to dependency often involves social problems such as desertion or the birth of an illegitimate child. These, in turn, are related to a large number of other factors such as lack of education, racial discrimination, inadequate housing, unemployment and even patterns of life than can be traced back to family relationships in slavery times. Not all of these factors need to be considered when seeking an explanation of the recent sharp upturn in the number of ADC recipients. There is no evidence and little likelihood that such things as levels of education or attitudes toward illegitimacy or desertion have changed rapidly enough to play a significant role. Two factors which could change rapidly enough are (1) the level of unemployment and (2) the legislative and administrative attitudes regarding eligibility for benefits and the amount of assistance to be provided.

Chart 1 shows that ADC recipient rates rose sharply after the 1957-1958 and 1961 recessions were well under way. In contrast, the recipient rate declined prior to the 1954-1955 recession and remained fairly steady during the recession. A fairly sharp increase in the recipient rate occurred in 1956, well after the recession.[66]

In fiscal year 1960, the Illinois recipient rate was exceeded in nineteen states, while the average monthly payment was higher in only ten. Comparison of the expenditure trends in Illinois with those in the U. S. and in selected other states reveals that the upswing in Illinois expenditure was not matched in most other states. The 1954 downturn which was so pronounced in Illinois is noticeable in the data for the U. S. and for several other states, but is generally not as great. Regression analysis suggests that the Aid to Dependent Children recipient rate is closely related to urbanization, unemployment, and low income. Even when these factors are taken into account, however, the rates in Illinois are significantly higher than in other states.

All of this suggests that economic conditions are powerful factors in

[66] The correlation between the unemployment rate and the recipient rate for the period from July, 1951, to March, 1961, excluding data from January, 1954, to April, 1955, is .73.

determining the level of ADC expenditure. On the other hand, there have been significant changes which have not been explained in this way. Specifically, the recipient rate in the 1954-1955 recession was lower than would be expected on the basis of economic conditions, while the 1961

TABLE 25

Aid to Dependent Children Expenditure Projections, 1962-1971

Fiscal Year	Recipient Rate*	Number of Recipients	Annual Expenditure† (in thousands of dollars—1961 prices)
		LOW PROJECTION	
1962	57.4	208,045	109,289
1963	60.0	224,100	117,716
1964	62.8	241,312	126,660
1965	65.5	258,542	135,814
1966	68.3	277,217	145,616
1967	70.9	294,318	154,600
1968	73.7	314,466	165,184
1969	76.4	334,424	175,673
1970	79.2	353,707	185,794
1971	81.8	374,664	196,805
		MEDIUM PROJECTION	
1962	61.7	223,714	117,514
1963	66.0	246,510	129,485
1964	70.4	270,841	142,273
1965	74.8	295,003	154,967
1966	79.1	321,065	168,656
1967	83.5	346,608	182,072
1968	87.8	374,902	196,935
1969	92.2	403,200	211,798
1970	96.6	431,416	226,613
1971	100.9	462,012	242,685
		HIGH PROJECTION	
1962	63.0	228,500	120,027
1963	69.2	258,611	135,849
1964	76.5	292,528	153,663
1965	83.5	329,570	173,148
1966	91.8	372,070	195,442
1967	100.8	418,320	219,739
1968	110.8	472,723	248,315
1969	121.6	531,824	279,335
1970	133.6	596,479	313,324
1971	146.8	671,867	352,922

*Number of recipients per 1,000 population under 18.
†Based upon an average monthly payment of $43.77.

upturn was significantly higher. It appears reasonable to suspect that policy changes of one kind or another were responsible for these deviations but it has not been possible to isolate them.

In projecting the ADC recipient rate, the recipients of ADC-U were excluded when trend lines were fitted. The projected recipient rates were then arbitrarily increased by 20 percent, which is approximately the percent of total recipients represented by the ADC-U in recent months.

Three different trend lines were fitted and three different projections

TABLE 26

Projected Expenditures in 1961 Prices, All Programs, 1962-1971

(Excludes Aid to Medically Indigent Aged)

Fiscal Year	ADC	OAA	Disability	Blind	General Assistance	Administration	Total
				(thousands of dollars)			
				LOW PROJECTION			
1962	109,289	66,337	26.418	3.180	79,486	24,086	308,796
1963	117,716	62,331	29,251	3.024	85.830	25,926	324.078
1964	126,660	58.834	32,036	2.948	91.817	28,267	340.562
1965	135,814	55,729	34.940	2.863	97,068	30,323	356.737
1966	145,616	52,126	38,128	2.826	104.806	33,145	376.647
1967	154,600	49.151	41.376	2,751	111,899	35,582	395.359
1968	165,184	46,543	44,457	2,555	119,020	38,734	416.493
1969	175,673	43.865	47,966	2,458	125,746	41,538	437,246
1970	185,794	41,530	51.308	2,488	131,851	44,868	457.839
1971	196,805	38,745	54.935	2,427	141.233	48.238	482.383
				MEDIUM PROJECTION			
1962	117.514	65,288	26,418	3.223	87,434	25.369	325,246
1963	129,485	62,194	29,251	3,112	94.413	27,692	346,147
1964	142,273	59.510	32.036	3,080	100,999	30,584	368.482
1965	154.967	57.133	34.940	3,035	106.775	33.150	390.000
1966	168,656	54.147	38,128	3.041	115.287	36.595	415.854
1967	182.073	51.735	41.376	3.001	123.089	39,686	440.960
1968	196,935	49,625	44.457	2.827	130,922	43.554	468.320
1969	211,798	47.367	47,966	2.758	138,320	47.050	495.259
1970	226,613	45.417	51,308	2.830	145,036	51.195	522.399
1971	242,685	42.899	54.935	2.796	155,357	55.408	554.080
				HIGH PROJECTION			
1962	120.027	64.239	26.418	3.266	95.383	26.169	335,502
1963	135.849	62,058	29.251	3.200	102,996	28.987	362,341
1964	153.663	60,185	32.036	3.211	110.181	32.519	391.795
1965	173.148	58,538	34.940	3.207	116,482	35,887	422.202
1966	195.442	56,167	38.128	3.251	125.767	40,406	459.161
1967	219,739	54.318	41.376	3.250	134.279	44.798	497.760
1968	248.315	52.707	44.457	3,098	142.824	50,386	541.787
1969	279,335	50.869	47.966	3.057	150.895	55.916	588.038
1970	313,324	49.305	51.308	3.171	158.221	62.508	637.837
1971	352.922	47,053	54.935	3,165	169.480	69.728	697,283

of recipient rates are shown in Table 25. The low projection is based upon a straight-line trend fitted to 1952-1962 data. This line does not fit the data very well, running well above the actual data in the 1945-1955 periods and well below that of recent years. Such a trend line is reasonable as the basis of a projection only if it is assumed that a downturn and a period of stability, similar to that of 1954 and following years, is to be expected.

The medium projection is based upon a straight-line trend fitted to 1955-1962 data.

The high projection is based upon a logarithmic trend fitted to 1955-1962 data. Use of this trend line implies that the recipient rate will continue to increase at the same percentage rate as it has in the 1955-1962 period.

A constant average payment, computed by converting the July, 1962, average to 1961 dollars is assumed.

Total Expenditures. Table 26 shows low, medium, and high expenditures for all programs and for administrative expenditures. The amounts shown for individual programs are those reported earlier except that when

TABLE 27
Projected Public Assistance Expenditure, by Program as Percent of Total
(Medium Projection)

Fiscal Year	OAA	ADC	Blind Assistance	Disability Assistance	General Assistance	Administration	Total
1962	20.1	36.1	1.0	8.1	26.9	7.8	100.0
1963	18.0	37.4	.9	8.5	27.3	8.0	100.0
1964	16.2	38.6	.8	8.7	27.4	8.3	100.0
1965	14.6	39.7	.8	9.0	27.4	8.5	100.0
1966	13.0	40.6	.7	9.2	27.7	8.8	100.0
1967	11.7	41.3	.7	9.4	27.9	9.0	100.0
1968	10.6	42.0	.6	9.5	28.0	9.3	100.0
1969	9.6	42.8	.6	9.7	27.9	9.5	100.0
1970	8.7	43.4	.5	9.8	27.8	9.8	100.0
1971	7.7	43.8	.5	9.9	28.0	10.0	100.0

only high and low projections were made for an individual program, the medium projection is obtained by averaging the high and low projections. Administrative cost projections are based upon the assumption that administrative costs will rise from 7.5 percent of total expenditure in 1961 to 10.0 percent in 1971.[67]

No projections are made for the Aid to Medically Indigent Aged pro-

[67] Increasing attention will probably be paid to rehabilitation and service aspects of the public aid program as the program becomes more expensive. Federal legislation permitting the federal government to pay 75 percent of the cost of rehabilitative programs will also encourage higher administrative expenditure. The increased importance of the General Assistance and Aid to Dependent Children programs will also tend to increase administrative costs.

gram. At present this program is very limited in scope and accounts for less expenditure than does the Blind Assistance program. If the program were to be expanded to the full extent permitted by federal law, it could become a very expensive program.

Table 27 shows the relative importance of the various assistance programs (medium projection). Comparison of this table with Table 4 indicates that the importance of the programs in 1971 will probably differ radically from the situation in 1946. In 1946 Old Age Assistance accounted for 63.9 percent of assistance expenditure. According to the projections this will have dropped to 7.7 percent in 1971. Aid to Dependent Children will have risen to 43.8 percent as compared with 19.4 percent in 1946. General

TABLE 28

Biennial Expenditure Projections by Source of Funds

(Medium Projection)

	1961-63	1963-65	1965-67	1967-69	1969-71
	(Thousands of dollars—1961 prices)				
Aid to Dependent Children					
Federal Funds	115,675	139,198	164,248	191,413	219,783
State Funds	131,324	158,042	186,481	217,320	249,515
Total Expenditure	246,999	297,240	350,729	408,733	469,298
Old Age Assistance					
Federal Funds	83,215	74,606	66,156	59,058	52,438
State Funds	44,267	42,037	39,726	37,934	35,878
Total Expenditure	127,482	116,643	105,882	96,992	88,316
Disability Assistance					
Federal Funds	26,686	32,102	38,108	44,302	50,928
State Funds	28,983	34,874	41,396	48,121	55,315
Total Expenditure	55,669	66,976	79,504	92,423	106,243
Blind Assistance					
Federal Funds	3,185	2,983	2,862	2,573	2,522
State Funds	3,150	3,132	3,180	3,012	3,104
Total Expenditure	6,335	6,115	6,042	5,585	5,626
General Assistance					
State Funds	140,022	159,986	183,550	207,316	231,303
Local Funds	41,825	47,788	54,826	61,926	69,090
Total Expenditure	181,847	207,774	238,376	269,242	300,393
Administration					
Feederal Funds	26,530	31,867	38,140	45,302	53,301
State Funds	26,531	31,867	38,141	45,302	53,302
Total Expenditure	53,061	63,734	76,281	90,604	106,603
All Programs*					
Federal Funds	255,291	280,756	309,514	342,648	378,972
State Funds	374,277	429,938	492,474	559,005	628,417
Local Funds	41,825	47,788	54,826	61,926	69,090
Total Expenditures	671,393	758,482	856,814	963,579	1,076,479

*Excludes aid to the Medically Indigent Aged.

Assistance will probably fluctuate considerably around the trend line due to cyclical variations but it is interesting to note that projected expenditures in 1971 are almost the same proportion of the total as they were in 1961.

Projected public assistance expenditure amounts to 1.33 percent of projected personal income for 1971.[68] This is substantially more than the 1961 figure of .94 percent and is twice the 1946 figure. It is, of course, still far below the 4.44 percent figure reached in 1938.

On a biennial basis, projected expenditures (medium) will exceed one billion dollars in the biennium which will start on July 1, 1969, and end on June 30, 1971.

If the present federal matching formulas remain in effect, state funds will amount to 58.4 percent of total expenditures in that biennium, while federal funds will make up 35.2 percent of the total. Local funds will be 6.4 percent.[69] Estimates for each program and each biennium are shown in Table 28.

APPENDIX

A Note on Statistical Sources

Throughout this report, instances will be found in which details do not add to the totals shown. This results from rounding the data. In some cases, as when monthly data were rounded to the nearest thousand before adding to annual totals or when computations involving several steps were made, the discrepancies are greater than might be expected from casual examination of the tables. In no case, however, are they great enough to have any significant effect on the conclusions.

Recipient rates plotted on Charts 1, 5, 9 and 13 were computed using numbers of recipients reported in *Public Aid in Illinois,* a monthly publication of the Illinois Public Aid Commission. Population estimates for the relevant age groups were obtained by interpolating from 1950 and 1960 U. S. Census of Population data. Recipient rates are plotted monthly.

Unemployment data plotted on the same charts were provided by the Illinois State Employment Service. Series 1 data are plotted bimonthly for 1957 and prior years. Series 2 data are plotted monthly for 1958 and following years.

Average monthly payments in Charts 2, 6, 10, and 14 were computed

---

[68] Based upon medium projection of public assistance expenditure shown in Table 26 and the medium projection of personal income made by Ferber and Ford.

[69] Because the average payment assumed in projecting expenditures for some programs is less than the maximum which the federal government will match, it is impossible to project the federal share without making some assumptions about the price level even though all projections are in terms of 1961 dollars. In computing the figures presented here, July, 1962, average payments were used. If the price level rises but payments in real terms are exactly as projected, federal grants will be larger than the amounts shown.

The federal grants for administration are assumed to be 50 percent of all administrative expenditure. Actually no federal grants are made for General Assistance administration while the federal portion of the amounts spent for approved rehabilitation and retraining programs is, under 1962 legislation, 75 percent.

Other 1962 legislation authorized additional federal matching of sums expended for medical vendor payments under the Blind and Disability programs if these programs are combined administratively with the other federally-aided programs. The Illinois Public Aid Commission estimates that federal funds would be increased by $126,000 per month if this option is adopted.

Local funds are assumed to amount to 23 percent of General Assistance expenditure.

from data in *Public Aid in Illinois.* Vendor payment data in Charts 6 and 10 are from *Social Security Bulletin* published by the U. S. Department of Health, Education and Welfare.

The Consumer Price Index — All Items was used to compute the average monthly payments (constant prices) shown in Charts 2 and 14. Average payments (constant prices) for Old Age Assistance and Disability Assistance were computed by deflating medical payments and money payments separately using the "medical care" and "all items" index. These are not shown in the report but reference is made to them in connection with the expenditure projections.

CHAPTER III

THE COMMON SCHOOLS

By

Eugene S. Lawler
Jacob O. Bach
Edward Griffin*

Introduction

Public education is a birthright of American children. It would be tragic for them to be denied full educational opportunity because of poor long range enrollment planning. This planning has become increasingly difficult because of the phenomenal population growth experienced by many states following World War II.

Population growth has been rapid since 1945. It has been greatest at the two age extremes, the younger and the older age groups. The increase in the young age group over pre-war levels results from the increased birth rate and decreased infant mortality. The rising older population is a result of the increased life span found among persons throughout the nation as a whole.[1]

Although the birth rate for the nation has decreased from the 1947 peak at 26.6 per thousand to 24.1 per thousand in 1959, the birth rate is still much higher than it was during the 1920's and 1930's. The birth rate for Illinois in 1956 was 24.2 live births per thousand population and equal in numbers to the all-time high reported for Illinois in 1947. This fact combined with the higher survival rates among the infant population has led to an increase in the number of pre-school and school-age children.

Long range predictions of school enrollments should always be a consideration in educational planning. Over-estimates of future school enrollments might commit a state to long term financial obligations for facilities and programs that might not be fully utilized. On the other hand, underestimating enrollment might cause a state to be completely unprepared for the school-age children to come.

In the 1959-60 school years, 1,787,869 students were enrolled in public elementary and secondary schools in Illinois.[2] This enrollment represented 17.7 percent of the total population of the state in 1960. Of this figure, 1,356,360 were enrolled in grades kindergarten to eight and 431,509 in grades nine to twelve. Note: These figures do not include students attending private elementary schools, tuition orphan pupils, pupils in military camps,

---

*The authors are respectively Professor of Education; Head, Educational Research Bureau; and Research Assistant, Educational Research Bureau, Southern Illinois University.

[1] Roscoe C. Brown, Jr., *Predicting School Enrollments*, The Center for School Services, New York University, Monograph No. 1 (New York: The School, 1961), p. 1.

[2] Office of Public Instruction, State of Illinois, *Annual Statistical Report of the Superintendent of Public Instruction*, Curricular Series A No. 142 (Springfield: The Office, 1960), p. 281.

and federal hospital areas, pupils in federally affected areas and pupils in non-recognized schools.

There are many factors that make it difficult to make accurate school enrollment predictions. However, fairly reliable predictions can be determined by an analysis of enrollment trends and factors affecting them. Probably the most significant factors are: (a) the number of recorded births; (b) expanding school programs such as kindergarten programs, vocational programs, and programs for special education; (c) school attendance and retention rates; and (d) population migrations. The school enrollment in 1960-61 was selected to serve as a focal point for viewing educational needs of the decade 1960-1970. Each of the preceeding factors will be considered in the early section of this chapter, followed by a comparison of school enrollment and population characteristics.

Birth Data

Birth data are public information and were obtained for this report from the health department records. Records for the years 1949 through 1960 were examined. This information is presented in Table 1.

Total births in Illinois have grown steadily during the years as indicated in Table 1. The greatest increase appears to have been recorded in the year 1954 when an increase of 10,416 births over the preceding year occurred. A comparison of total births in 1949 to births in 1960 shows an increase of 49,591 or 79.23 percent. The average annual increase is calculated as being 4,133. The rise in births was and will continue to be reflected in public school enrollments.

One serious implication is considered in this study. Enrollment pres-

TABLE 1

Illinois Births 1949-1960

Year	State	Downstate	Chicago
1949	189,169	110,304	78,865
1950	189,628	111,375	78,253
1951	201,082	119,281	81,801
1952	205,438	122,714	82,724
1953	206,813	125,179	81,634
1954	217,229	130,410	86,819
1955	220,541	133,722	86,819
1956	229,571	140,546	89,007
1957	238,579	146,091	92,448
1958	234,712	144,321	90,391
1959	239,871	148,665	91,206
1960	238,760	150,463	88,297

SOURCE: Data from Division of Vital Statistics, State Department of Health, Springfield, Illinois.

sures are not always equally distributed throughout the State. Some communities find that a rapid increase in pre-school and school-age children has caused an almost impossible task for schools in "keeping pace" with the growth. Little can be done to forestall such rapid changes in school enrollments, but much can be done to anticipate changes and plan how to deal with them. This fact underlines the need for both short and long range school enrollment predictions. Further discussion of this important topic will be presented in the section, "Population Characteristics."

School Programs

Kindergarten

Perhaps the most significant change in public school enrollment between 1940 and 1960 was the sharp increase in the number of kindergarten pupils. The kindergarten enrollment rose in Illinois from 45,988 in 1940 to more than 160,768 in 1960. The trend in public kindergarten enrollment is shown in Table 2.

TABLE 2

Number of Kindergarten Pupils in Public Day Schools in Selected Years

School Years	Number of Pupils in United States	Percent of Number in 1940	Number of Pupils in Illinois	Percent of Number in 1940
1939-40	594,856	100.0	45,988	100.0
1949-50	1,039,588	174.8	76,909	167.2
1955-56	1,566,409	263.3	122,768	266.9
1957-58	1,785,572	300.2	143,156	311.3
1959-60	1,890,974	317.9	160,678	349.4

SOURCE: U. S. Department of Health, Education, and Welfare, Office of Education. Biennial Survey of Education in the United States.

In some states the kindergarten enrollments are noticeably larger than those for first grade, indicating that a substantial number of 4-year olds and/or subsequent parochial pupils are classified as kindergarten pupils. The data in Illinois indicate a smaller kindergarten enrollment when compared to first grade. As more communities move in this direction, public school kindergartens may be expected to increase. Total enrollment predictions for kindergartens are included in the section on school enrollment projection.

Special Education

Information prepared by the U.S. Office of Education lists 968,554 children enrolled in special education programs of 48 states in public and private schools during 1957-58. By 1959-60 a total of 1,177,209 were reported enrolled in special programs in public schools, but others are being educated at home, in hospitals, and in special schools. Ten years ago, several

states had only very minor programs for handicapped children, however, the annual increase in enrollment in special schools and classes for exceptional children far surpassed the percent of increase in total public school enrollment.

The School Code under Article 14-1 gives school districts in Illinois the right to establish and maintain special education services which are required. Throughout the state there are classes for the educable mentally handicapped, the trainable mentally handicapped, the partially seeing and the hard of hearing. In addition individual and group assistance is given in speech therapy, for the physical and multiple handicapped, for homebound children and for gifted children. Social counselors for maladjusted children and school phychologists are available to some school districts. Articles 14-6, 14-8 outline limitations on and regulations for the establishment of special education classes. Articles 14-6, 14-8 are concerned with the financing of programs.

Each year county superintendents are required to take and report a census for special education to the Office of the Superintendent of Public

TABLE 3

Actual and Estimated Enrollment in Special Education in Illinois for Selected Years

Year	Enrollment	Reimbursement for Excess Cost
1949-50	51,769	$4,700,000
1954-55	60,346	5,400,000
1959-60	79,515	7,478,936
1960-61	82,037	7,475,211
1961-62	84,559	7,705,016
1962-63	87,081	7,978,376
1963-64	89,603	8,164,625
1964-65	92,125	8,394,430
1966-67	94,647	8,624,234
1967-68	97,169	8,854,039
1968-69	99,691	9,083,843
1969-70	102,213	9,313,648

SOURCE: See footnote 2.

Instruction. Data taken from Annual Statistical Reports[3] of the Office were used to make an estimate of future special education enrollments and costs.

Table 3 makes no provision for improvements in the special education programs in the State. Predictions were based on the trends during the school years 1949-50 to 1959-60. Therefore, nationally established minimal

[3] Office of Public Instruction, *State of Illinois, Annual Statistical Report of the Superintendent of Public Instruction.* Curricular Series A No. 14-142 (Springfield: The Office, 1949-1960).

percents of exceptional children were used in Table 4 to bring attention to more realistic needs in this area.

The state, recognizing the incidence factor, permits school districts to establish adequate programs. Comparing the total number of children based on present trends with minimal percents, we find that in the sample school years 1964-65 and 1969-70, respectively, 92,125 and 102,213 are expected to be receiving aid when the real need estimated for the years are 262,860 and 324,008. Even with many programs underway it is apparent that new efforts need to be made to expand special education on both the district and state levels.

TABLE 4

Minimal Percents of Incidence of Exceptional Children and Estimated Pupils in Illinois

Type of Incidence	Percent of Incidence*	1960-61 No. of Pupils†	1964-65 No. of Pupils†	1969-70 No. of Pupils†
Mentally Retarded	3	53,463	60,756	65,900
Gifted	2	35,642	40,504	43,933
Speech Impaired	6	106,926	121,510	131,800
Auditorially Handicapped	1.5	26,732	30,378	32,950
Visually Handicapped	.25	4,455	5,063	5,491
Physically Handicapped	1.0	17,821	20,251	21,966
Socially and/or Emotionally Handicapped	1.0	17,821	20,251	21,966
Totals	14.75	262,860	298,713	324,008

SOURCE:
*T. Ernest Newland *et al.*, *How to Conduct a Self-Survey of Special Education Needs*, International Council for Exceptional Children, (Washington, D. C., 1958), pp. 44-45.
†Based on actual enrollment records of Illinois in 1960; median projection enrollments are used in 1965 and 1970.

School Attendance and Retention Rates

There has been a trend toward more regular attendance of the pupils enrolled in recent years. In 1939-40, the national average daily attendance for public elementary and secondary school pupils combined was approximately 86.7 percent of the total enrollment. This national percentage has increased and reached approximately 90.2 percent for 1959-60.[4] The data for Illinois indicate that the figures are comparable to the national average, reaching the 92.3 percent in 1959-60. Drop-outs, however, are a continuing problem in education. While pupils generally stay in school at least to the extent required by law, some pupils drop out before completing the eighth grade.

Pupils drop out of school for several reasons. In some cases they are poor achievers. The poor achiever, considered a failure by the teacher,

[4] U. S. Department of Health, Education, and Welfare, Office of Education. "Statistics of State School Systems," Table B, (Washington, D. C.: The Office, 1960), p. 9.

pupils, parents, and by himself is insecure in his classroom. He feels that the sooner he can escape from school, the happier he will be. While many other factors contribute to the making of the drop-out, the school must assume a part of the responsibility. When the home life of a pupil does not provide the basic requirements necessary for the successful completion of secondary or even elementary school the school must make-up the lack so far as possible. Specific assumptions concerning drop-outs and retention rates will be made in relation to the various enrollment projections.

Migration

Classic examples of in-migration of communities may be found in many urban areas throughout the state. The attraction of "suburbia" has caused population changes of enormous amounts in relatively short spans of time. This attraction has caused a lower rate of growth in large cities with a corresponding out-migration of some former city residents. These population movements both within the state and from the outside of the state will be presented in the section "Population Characteristics." A figure illustrating the rural migration will also be presented.

Future Public School Enrollments

General Assumptions

To project school enrollments, it is necessary to make several assumptions concerning trends in the proportion of children who will be in the public schools and the proportion that will be educated at various levels, as follows:

Assumption one: That public and nonpublic elementary and secondary school enrollments will continue to have the same relationship to each other in the decade 1960-70 as they did in the school year 1960-61.

Assumption two: That the schools will remain as attractive to students as they have been in the past.

Assumption three: That classroom space will be available for additional students.

Assumption four: That employment opportunities for high school students will remain at the present low level or decrease.

Rounding of Projected Enrollments

Since enrollments are recorded in total students, the projected enrollment was rounded to the nearest whole number. Retention rates from year to year were rounded to thousandths with the exception of kindergarten and first grade enrollment ratios which were rounded to hundredths.

Procedures in Making Projections

Step 1. The first step in computing school enrollment projections is to obtain accurate public school enrollment and birth data. Birth data were obtained from the Division of Vital Statistics, State Department of Health, Springfield. Public school enrollment data were obtained from Division of School Statistics, Office of Public Instruction, Springfield.

Step 2. The retention ratios for each grade for the most recent school year and the prior years dating back to 1949-50 were computed. The retention ratio is the ratio between the number of children in a given grade divided by the number of children in the preceding grade the year before.

Step 3. A ratio between births and kindergarten enrollments was calculated for each of the school years 1952-53 through 1960-61, by dividing a given kindergarten enrollment by births five years prior. A ratio between births and first grade enrollment for each of the years was found by dividing a given first grade enrollment by births six years prior.

Step 4. Step 4 consists of the selection of an appropriate birth assumption and an enrollment ratio for years that data are not available in Step 3. The enrollment rate is then applied to assumed births in both the kindergarten and first grade.

Step 5. Selected retention ratios are applied to actual enrollment grades 1-12 during the school year 1960-61. This step is carried out using projected enrollments for subsequent years until the desired year is reached. (1969-70 in the projection).

Step 6. Enrollment predictions for each school year are added with sub-totals after grades eight and twelve. A separate total using one-half of kindergarten enrollment was determined for cost purposes.

Projection

Three enrollemnt projections were made for this report. (See appendix for projections) Various assumptions are developed in relation to each projection.

Projection 1—(Conservative)

The number of children who will be enrolled in the public schools in the decade 1960-1970 will bear the same ratio to the population age group in the state as in 1960-61. Enrollment rates obtained for kindergarten will remain at the level reached during the school year 1960-61, (74.34). Enrollment rates obtained for first grade will remain at the level reached during the school year 1960-61, (84.99). Retention rates will be similar to those arrived at by the mean method (last three years) which gives a conservative estimate.

Projection 2—(Expected)

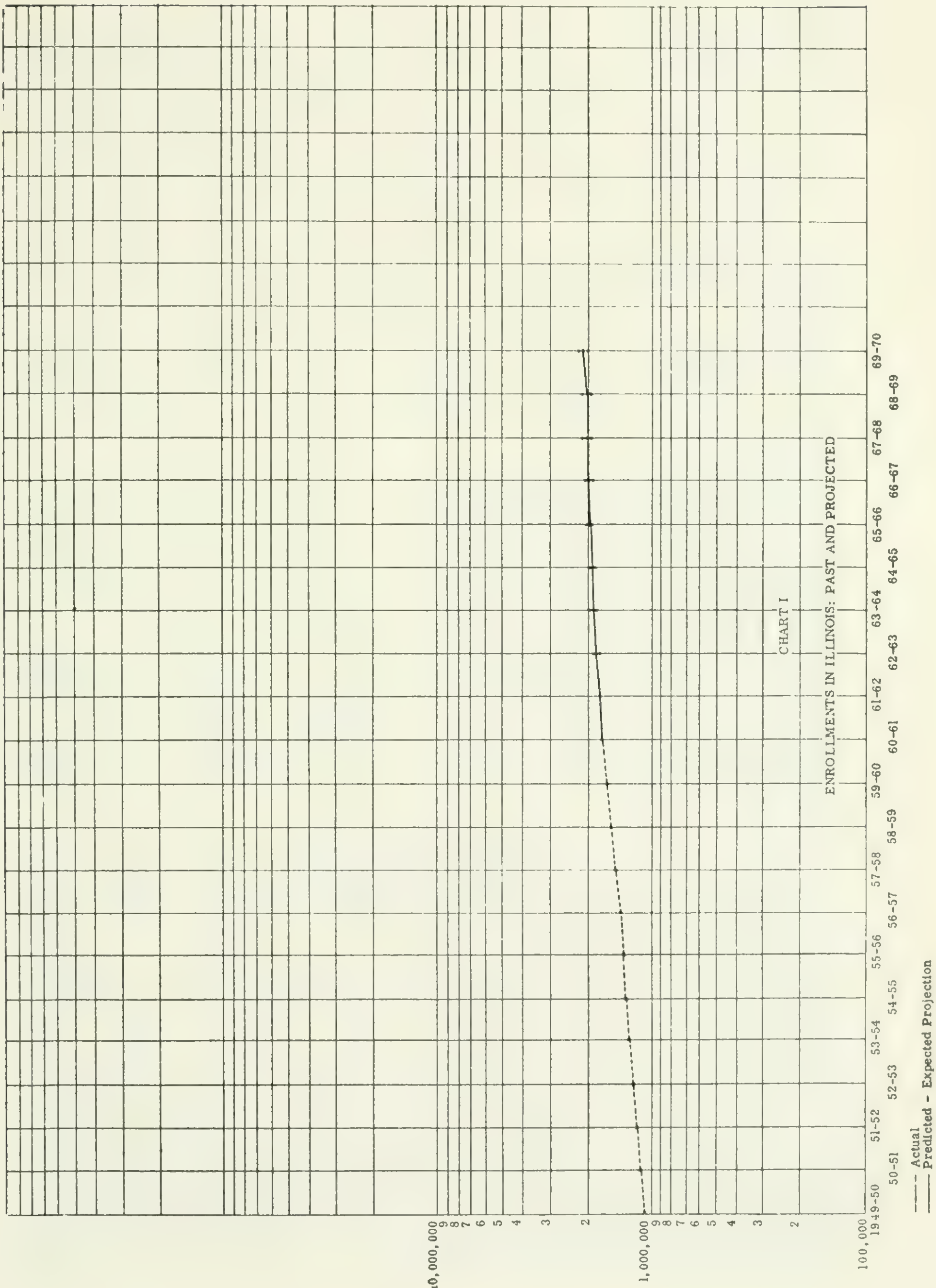
Enrollment trends of the past decade will continue through 1970. The enrollment ratio for kindergarten will rise to 75.00 percent and then level off. Enrollment ratios for first grade will reach 86.34 percent and then remain constant. Median retention (five years) rates will indicate the future growth.

Projection 3—(Liberal)

Total public school enrollment for the decade 1960-1970 will be indicated by the trends of the preceding six school years. Enrollment ratios for kindergarten will continue to rise at the rate of 1.00 percent each year. Enrollment ratios will be the median for the last five years, (88.29). There

CHART 1

Enrollments in Illinois: Past and Projected



will be an increase in the proportion of secondary school enrollments. Dropout rate will decrease throughout the state.

Analysis of Projection

In order to gain a comprehensive view of the past and future enrollments a chart was developed using semi-logarithmic graph paper. First, actual enrollments from the school years 1949-50 to 1960-61 are charted. The next step was to chart the conservative, expected, and liberal projections for the projected school years 1961-62 through 1969-70. The line connecting points moved from the actual to expected projection points.

Enrollment in Illinois increased at a stable rate throughout the entire years charted. Slightly greater inclines are shown in the school years, 1954-55, 1956-57 and 1957-58. However, this incline appears to level off and continue rising at a constant rate throughout the entire projection. An upturn may again occur in the later years of this projection. Because this upturn may not take place until the latter years of the projection some caution must be exercised in the interpretation of the final years of the projection.

Using the expected projection (No. 2), the increase from the year 1949-50 to 1969-70, was determined to be 1,060,556 pupils. The increase in the predicted school enrollment from the school year 1960-61 to 1969-70 (nine years) was 414,584. This compares with the increase of 590,461 for the preceeding period of eleven years. The average annual increase during the twenty years was estimated as being about 50,000 pupils.

On the basis of the enrollment projections made and the assumptions which underlie the projection (No. 2) probably the best general statement which can be made is that by 1970 approximately 415,000 more pupils may be expected to be enrolled in the public schools of Illinois, than were enrolled the base year of 1960-61.

Population Characteristics

"City Limits of Masonville—Population 9,500." A succession of such signs greets the motorist as he drives across the State of Illinois. Further observations reveal a close relationship between the size of the community and the services that it maintains. A village of 600 may include one or two churches, several garages, several grocery stores, and perhaps a school. A community of 10 to 20 thousand people will not only include highly specialized economic services, but medical services, movie theatres, and a variety of social organizations and agencies not present in the smaller village.

In addition to the factor of size, other factors of population composition, such as age, sex, and geographical distribution are important. Birth and death rates and the incidence of these items on the various segments of the population must be examined. All such factors up to this point are considered because predictions are based on actual experience of public schools in enrollment and attendance.

Migration Trends

Migration trends must be further analyzed in relation to the predicted increase of approximately 500,000 pupils in the decade 1960-1970. Were population characteristics relatively stable and simple to understand, the task of enrollment prediction would have disappeared long ago in favor of clerks and librarians, the one to collect and make changes in statistics, the other to classify and place in permanent records the material found. It is sufficient to note, then, that a population overview remains a human formulation, viewed by people and therefore must to a degree be an arbitrary one.[5]

In times past a view of community might have been gained by noting the place where tire marks led to one town or another. Where the last tire marks turned toward a certain community was said to be the outer limits of a community. Using this criterion today, it would be a very difficult project to find the line where one community ends and another begins.

During the past two decades, there have been attempts to develop the concept of emerging outer rings of urbanized areas. Two conceptions currently employed are "suburbs" and "rural-urban fringe." The term "suburban" may be traced back to the early work of Adna F. Weber, *The Growth of Cities in the Nineteenth Century*.[6] The concept of rural-urban fringe can be dated back scarcely twenty years in sociological literature. Accordingly a working definition of the suburb might be: "those urbanized, residential communities which are outside the corporate limits of a large community, but which are culturally and economically dependent upon the central city."[7] Some variation in definition is typical of writers in the field but Blizzard and Anderson's definition of rural-urban fringe serves our purpose: "From an applicational point of view in research, the rural-urban fringe has usually been designated as that area of mixed urban and rural land uses between the point where full city services cease to be available and where agricultural land uses predominate."[8] Thus, the rural-urban fringe is seen more as a land belt surrounding the central city than is the urban fringe.

The suburbs are characteristically urban in their features and land use. In plotting a model urbanized area in terms of the characteristics, mentioned above, the three major areas become apparent. (See figure A). In the very center is the built-up central city with its central business and subareas. Outside the corporate limits of the central city lies the functional area, the suburban zone. Beyond the belt of suburban town and village lies the third functional area of the urbanized area, the rural-urban fringe.

---

[5] Harlan D. Beem, *An Introduction to Legal Bibliography for the Non-Professional Student* (Carbondale, Illinois: Educational Research Bureau, Southern Illinois University, 1960), p. 1.

[6] Adna F. Weber, *The Growth of Cities in the Nineteenth Century* (New York: Columbia Press, 1899).

[7] Samuel W. Blizzard and William F. Anderson, *Problems in Rural-Urban Fringe Research Conceptualization and Delineation*, The Pennsylvania State College Agricultural Experiment Station, Progress Report 89, (State College, Pennsylvania, November, 1952). Mimeo, p. 11.

[8] *Ibid.*

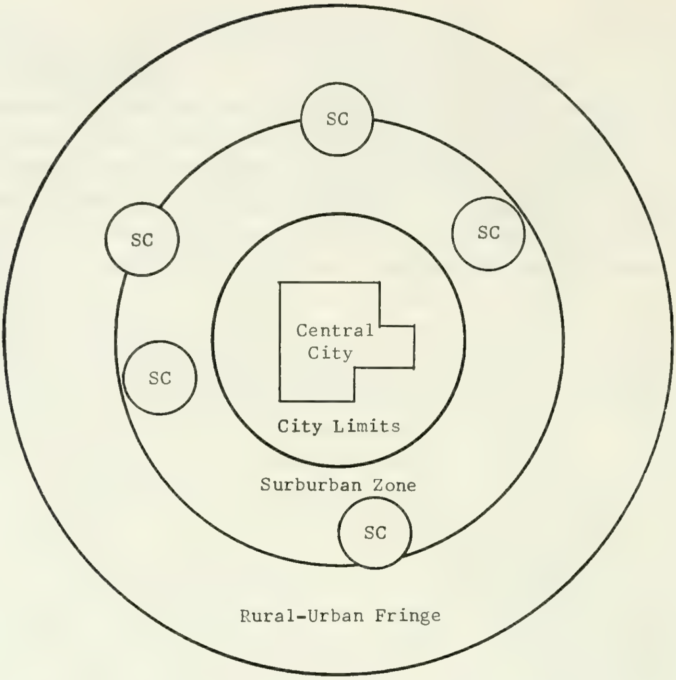


Figure A—A model urbanized area showing the relationship of a central city with the suburban zone, suburban community (SC) and rural-urban fringe.[9]

William M. Dobrines[10] in the book, *The Suburban Community* analyzes the characteristics of suburban areas. When compared with central cities, the suburbs have higher fertility ratios, higher percentages of married persons, higher socio-economic status, higher median income, lower median age, a higher percentage of mobile families and a higher level of educational achievement. In addition suburban communities are likely to have an excess of persons aged 0 to 18 and 25 to 44, with a lower ratio of persons aged 45 and older.

Migration to urban areas constitutes an important phase of school enrollment prediction in individual communities. This is important not only because of the great number of rural to urban migrants but because of the cultural impact on the areas involved. Data from recent census studies indicate that a third of the adult nonfarm people in urban areas of our nation in 1952 were reared on farms. Stated in another way, less than half of those adults who have been reared on the farm remain there, especially after the completion of high school.[11]

[9] R. E. Park, E. W. Burgess, and R. D. McKenzie, *The City* (Chicago: The University of Chicago Press, 1925), p. 51.

[10] William M. Dobrines (ed.), *The Suburban Community* (New York: G. Putnam's Sons, 1958), pp. vii and xxv.

[11] Ronald Freeman and Deborah Freedman, "Farm-Reared Elements in the Nonfarm Population," *Rural Sociology*, Vol. 21, No. 1 (March, 1956), p. 50.

At the time of the first federal census in 1780, out of a population of approximately four million people only five percent were urban. In 1950, approximately 96 million or 64 percent of the people in the nation were living in urban areas. By 1960, approximately 126 million or 69.9 percent were living in urban areas.[12] How far and how rapidly this trend will continue cannot be known with certainty.

The 1960 Bureau of Census report in Illinois further bears out the migration pattern. The report shows a significant increase in urban areas as a whole. Central cities and other urban places have decreased in the percentage of total population along with rural areas. The percentage of population in urban fringe areas has increased in the decade 1950 to 1960 from 14.7 to 24.6.

TABLE 5

Population in Groups According to Size, 1950 and 1960

1960	Population	Percent of Total Population		
Illinois	10,081,158			100
Urban	8,140,315		80.7	
Central Cities	4,243,487	42.1		
Urban Fringe	2,475,468	24.6		
Other Urban	1,421,360	14.0		
Rural	1,940,843		19.3	
			100.0	100
1950				
Illinois	8,712,176			100
Urban	6,759,271		77.6	
Central Cities	4,059,749	46.7		
Urban Fringe	1,284,863	14.7		
Other Urban	1,414,659	16.2		
Rural	1,952,905		22.4	
			100.0	100

SOURCE: U. S. Bureau of Census, *United States Census of Population, 1960.*

Ten urbanized areas were defined in the report of the Bureau of Census. "An urbanized area may be thought of as divided into a central city, or cities, and the remainder of the area, of the urban fringe. Any city in an urbanized area which is a central city of a metropolitan area is also a central city of the urbanized area. It has been long recognized that for many types of social and economic analysis it is necessary to consider as a unit

[12] U. S. Bureau of Census, *Statistical Abstract of the United States, 1962*, Eighty-third Edition (Washington, D. C.: U. S. Government Printing Office), p. 21.

the entire population in and around the city whose activities form an integrated social and economic system."[13]

Urbanized Areas:

1. Aurora, Ill.: Part of Kane County
2. Champaign-Urbana, Ill.: Part of Champaign County
3. Chicago-Northwestern Indiana, Ill.-Ind.: Part of Cook, DuPage, Lake, and Will Counties, Ill.: Part of Lake and Porter Counties, Ind.
4. Davenport-Rock Island-Moline, Iowa-Ill.: Part of School County, Iowa; of Rock Island County, Ill.
5. Dubuque, Iowa-Ill.: Parts of Dubuque County, Iowa, and of Jo Daviess County, Ill.
6. Joliet, Ill.: Part of Will County, Ill.
7. Peoria, Ill.: Part of Peoria and Tazewell Counties, Ill.
8. Rockford, Ill.: Parts of Winnebago County, Ill.
9. St. Louis, Mo.-Ill.: St. Louis City; part of St. Charles and St. Louis Counties, Mo.; of Madison and St. Clair Counties, Ill.
10. Springfield, Ill.: Part of Sangamon County, Ill.
11. Decatur, Ill.: Part of Macon County, Ill.

Urban population will doubtless continue to increase in the decade 1960-1970. *Heavy* enrollment pressures can be expected to be exerted on suburban and rural urban fringe areas. With the anticipated enrollment increase predicted in all three projections and migration to urbanized areas, the school districts which educate the children in the suburban and urban fringe will be hard pressed to provide adequate educational opportunities for all.

Transportation

Public funds for the purpose of transporting pupils to and from schools were first legalized in Massachusetts in 1869. Other states were slow in following the pattern set by Massachusetts. With the advent of the bus and the development of paved roads, pupil transportation became an important part of the public school expenditures in all states.

Basic to the provisions of transportation is the philosophy that all children, regardless of residence, should be provided equal educational opportunities. A result of this philosophy is the rapidly growing segment of pupils attending school in rural, urban-fringe, and suburban attendance centers. Without adequate transportation the desire for good schools cannot be met in these areas.

The rapid growth of student transportation in recent times has been noticed by many school officials. For the school year 1919-20, the U.S. Office of Education reported that 356,000 students, or approximately 1.7 percent of the total enrollment, were transported. By 1925-26, the number

[13] U. S. Bureau of the Census, *United States Census of Population, 1960.* (Washington, D. C.: U. S. Government Printing Office, 1961), p. XII.

had more than tripled. In 1957-58 more than 33,528,591 students, approximately 32.4 percent of all those enrolled in the public schools in the United States were transported. Significant and rapid as the growth of student transportation has been, all evidence indicates an even further expansion in the future.

It is interesting to note past trends, in the percent of pupils transported in Illinois as compared to the national average, show a lower average. For example, in the school year 1959-60, the percent transported in the United States was 33.6 while in Illinois the percent was 25.1 or 8.5 percent lower than the national average.

Predictions of the number of pupils that may need to be transported in Illinois in the decade 1960-70 were based on ADA enrollment projections. By the school year 1969-70, it is expected that 675,043 pupils will be transported daily. This estimate represents about one-third of the total ADA which is near the United States average in 1959-60.

The movement of yellow school buses each day represents a task of great magnitude. The student transportation system has not been undertaken merely as a convenience to children and parents. It is an essential part of the philosophy that all children should be provided adequate educational opportunities. The trend of the decade 1960-70 indicates that an even greater number of school children will need to be transported at public expense. The increase is presented on the accompaning graph. The line indicating the number of school districts shows a slight decrease. The two lines depicting the amount claimed in millions of dollars and the number of pupils transported show the upward trend of the prediction.

Economic Growth

Historically, the view has prevailed that economic growth is basically a matter of amassing more tangible capital. In recent years, some economists have presented the viewpoint that growth may be influenced by developing human talent and that economic growth can be fostered by the allocation

TABLE 6

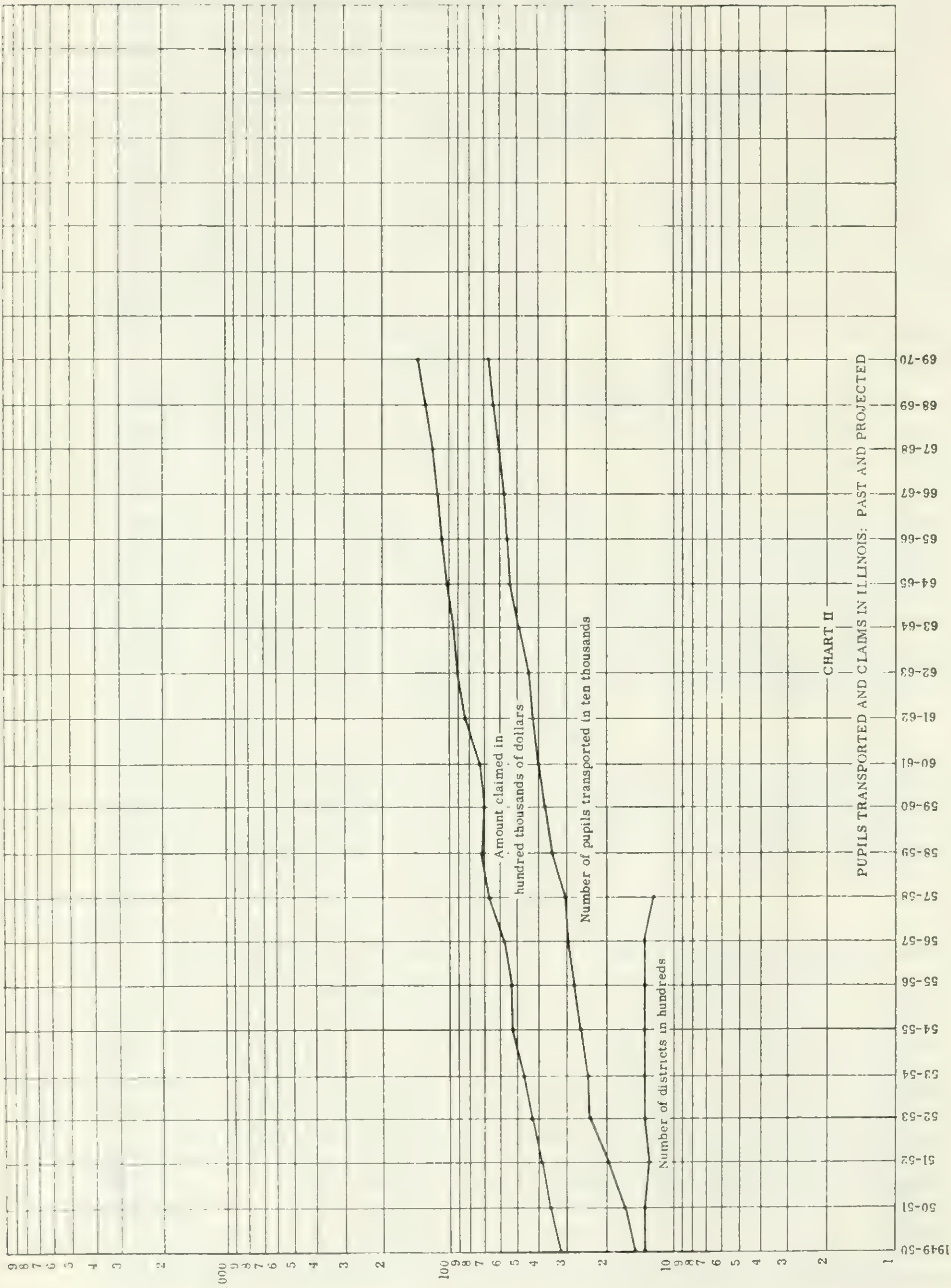
Public School Enrollment and Percent of Enrollment Transported at Public Expense

School Year	Public School Enrollment U. S.	No. of Pupils Trans.	Percent Trans.	ADA Trans. in Ill.	Percent of ADA Trans.	Claim
1949-50	..25,111,427	6,947,384	27.7	161,083	15.4	$ 3,117,507
1957-58	..33,528,591	10,861,689	32.4	301,818	22.8	6,822,294
1959-60	..36,004,661	12,108,336	33.6	377,572	25.1	7,164,883
1963-64	..			492,290	28.3	9,678,421
1969-70	..			675,043	33.7	13,271,345

SOURCE: *Annual Statistical Reports, Superintendent of Public Instruction 1949-50, 1959-60.*

CHART 2

Pupils Transported and Claims in Illinois: Post and Projected



of financial appropriations for the development of talent. In a report published in 1961 entitled *Education and Economic Growth*, Harold M. Groves emphasizes the need for increased investment in education as an important factor in economic growth and that such growth can no longer be based on estimates of tangible capital.[14]

One of the early standard works in economic thought, *Principles of Economics* by Alfred Marshall, observed that it would "be profitable as an investment, to give the masses of people much greater opportunity than they generally avail themselves of," adding that "the economic value of one great genius is sufficient to cover the expenses of the whole town; for one new idea such as Bessemer's chief invention adds as much to England's productive power as the labor of a hundred thousand men."[15]

Adam Smith, widely known as the father of economics, was greatly concerned about economic growth. He laid much emphasis upon techniques as a means of achieving economic growth such as: organization, free markets, capital investment, skills. Smith offers some insights into education but he seems to prefer to write in terms of tangible capital such as machines, inventories, buildings, etc. Other early economists (Malthus, Mill, Ricardo) seemed insensitive to the potentialities of economic improvement by means of educational training. They stressed capital, savings, and natural resources as principal factors in economic development. Mill considered education as an investment only if it increases the productivity of the individual. Generally, early economists took a narrow view of education, and were oblivious of its contribution to economic progress.[16]

Theodore W. Schultz in 1959 wrote an article on the human element in economic development. He observed that the study of the investment in man has long been neglected by modern economists and that the "main stream of modern economics has bypassed understanding any systematic analysis of human wealth." He concludes that education involves an enormous amount of social and private saving that is generally ignored by statistics.[17] In 1961, Charles S. Benson of Harvard University published the book, *The Economics of Public Education*.[18] In his work he emphasizes that certain benefits of an education are of value to an individual while others are of value to all members of society.

Comparisons among countries are indicative of the relationship between educational development and per capita income despite advantages or disadvantages in natural resources that would create reverse expectations. Norton submits, for instance, facts shown in Table 7.

---

[14] Harold M. Groves, *Education and Economic Growth*, National Education Association. Committee on Educational Finance (Washington, D. C.: the Association, 1961), p. 5B.

[15] Alfred Marshall, *Principles of Economics* (New York; Macmillan Co., 1936), p. 871.

[16] Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (Edinburgh: Adam and Black, 1870), p. 353.

[17] T. W. Schultz, "Investment in Man: An Economist's View," *Social Service Review*, Vol. 33, No. 110 (June, 1959), p. 109.

[18] Charles E. Bensen, *The Economics of Public Education* (Boston: Houghton Mifflin Company, 1961), p. 93.

TABLE 7

National Development

Nation	Natural Resources	Educational Development	Per Capita Income 1952-54
Brazil	High	Low	$ 230
United States	High	High	1,870
Denmark	Low	High	750
Mexico	High	Low	220
New Zealand	High	High	1,000
Colombia	High	Low	250
Switzerland	Low	High	1,010

SOURCE: John K. Norton, "Education Pays Compound Interest," *National Education Association Journal,* Vol. 47, No. 8 (November, 1958), pp. 557-59.

Nations with high educational development, though lacking in natural resources, have frequently raised themselves to economic leadership. On the other hand, we note the situation of some nations, such as Colombia, which suffers seriously from a lack of education. The shortage of trained personnel in most areas holds back economic progress. Foreign assistance focused on tangible capital would probably prove of small value without a corresponding development of human resources. As suggested above, the discovery of large intangible factors among the elements of economics has opened a new field for research. The National Bureau of Economic Research recognized this and has inaugurated projects which seek to illuminate the causes of accelerating efficiency.

Universal Economic Problems

At the foundation of most communities there are always found three universal conditions. Certain universal conditions are as evident today in our modern economy as they were in the days of Homer and Caesar. And judging from the content of Aldous Huxley's *Brave New World,* they will continue to be relevant in the years ahead.

All nations, whether they consist of a tribe of islanders, a communistic state, or an industrial nation must meet at least these fundamental economic problems.

1. What commodities shall be produced and in what quantities? That is, how much and of which of a choice of alternative goods and services shall be produced?

2. How shall goods be produced? By whom and with what resources?

3. For whom are the goods to be produced? Or, to put the same thing in another way: How is the total national product to be distributed among different individuals and families?

Nations, as separate entities or as combined groups, attempt to solve these economic problems differently. In a primitive culture the What, How,

and For Whom may be divided according to the traditional way of doing things. The Kwakiutl Indians consider it a favorable objective not to accumulate wealth but to give it away in the "potlach"—a great celebration. This action would not surprise anthropologists because they know that what is considered correct behavior in one culture is often a serious crime in another. At the other extreme we can remember examples of the autocratic dictators of World War II, who by arbitrary decree decided on What, How, and For Whom. The task of our state as well as the nation is to decide what amount of the wealth is to be used to produce goods and services for future decades as well as for immediate consumption. The importance of the human element should be of vital concern to those interested in the welfare of the state.

United States Wealth

The United States produces an abundance of all goods and services. The following six statements summarize a recent review of the American economy.

1. Total production in the United States is about two and a half times that in the boom year of 1929 and can be expected to continue to increase for the decade 1960-70 at an even larger rate of growth.

2. During the past 30 years, output per manhour has increased at the rate of about 2.5 percent annually. This rate is expected to be higher in the future with additional technological improvements.

3. The benefits of mass-production are more widely shared among Americans than ever before or in most other countries.

4. The nation is better prepared to counteract economic instability than in the past.

5. Per capita income has constantly risen since 1929, and is much higher than in any other country.

6. The United States comprises only 6 percent of the world's population, yet accounts for about one-third of the total industrial production of the world.[19]

Regional Development

The next step is to look at the State of Illinois in relation to the region in which it is located. Some descriptions refer to its region as the Middle-Western States, others call it the Great Lakes region.

This region is viewed as the end of the manufacturing belt which extends from the Atlantic seaboard westward. The westward movement of the population has given the area favorable access to national and international markets as well as local markets. The development of the St. Lawrence Seaway is adding to the potentialities of the region.

In 1960, per capita income of the people of the region was well above the national average. Illinois for example was 17.5 percent above the United

[19] Gerhard Colm and Theodore Gerges. *The Economy of the American People.* Planning Pamphlet No. 115 (Washington, D. C.: National Planning Association, October, 1961), p. 9.

States average. Michigan and Ohio were 4.5 and 5.2 percent above respectively. However, Indiana and Wisconsin were listed as being 2.0 and 2.3 percent below in that order.

Projections for 1970 indicate only slight changes in the position of the Great Lakes states on the basis of per capita income relative to the United State's average.

TABLE 8

Per Capita Income of Great Lakes States As Percent of the National Per Capita Income 1950, 1960, 1970

States	1950	1960	1970
Ohio	108.1	105.2	107.7
Indiana	101.9	98.0	97.9
Illinois	122.5	117.5	118.3
Michigan	112.8	104.5	103.5
Wisconsin	98.4	97.7	98.9
Great Lakes	113.3	106.7	107.4

SOURCE: National Planning Association, Pamphlet No. 115, quoted in *Financing the Public Schools 1960-70*, National Education Association, 1962.

As measured by the population and income, the Great Lakes region has shared in the prosperity of the economy of the United States. Changes in the projected data were considered to be moderate. The changes predicted for the decade ending in 1970 appear to continue in the established pattern.

Per Capita Income in the United States and Illinois

The State of Illinois has enjoyed a per capita income somewhat above the average level for the United States. Per capita income is defined in the *Dictionary of Modern Economics* as:

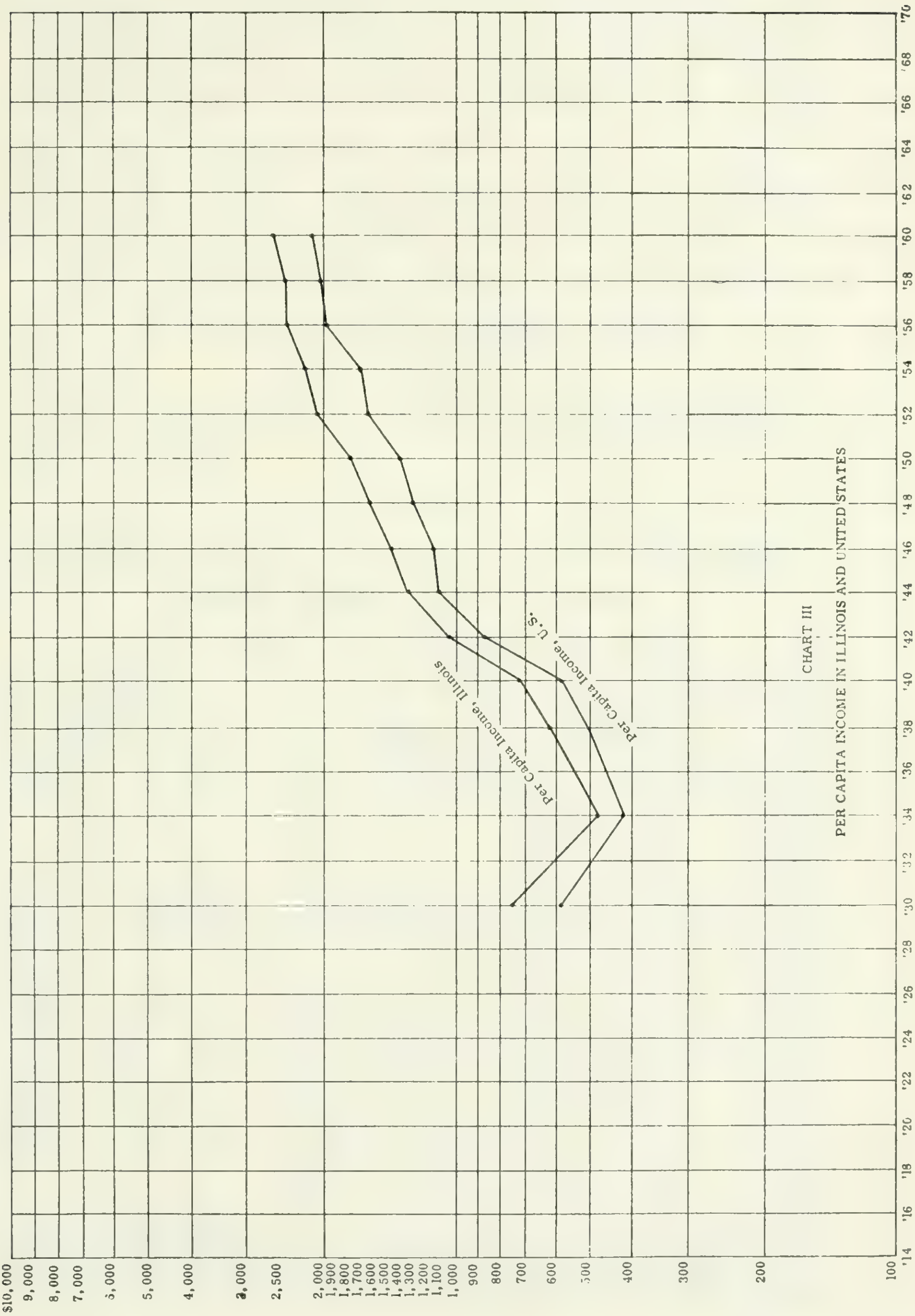
> An expression used in reference to computation made on the basis of each person in the population. The total per capita income of a country is the total income divided by the number of persons in the population.[20]

In order to further emphasize the economic position of the people of the State of Illinois, the per capita income in Illinois was compared to the income in the United States for the years 1930 to 1960. (Note: Illinois is included in United States data.) The comparison is shown in the accompaning chart. Data are taken from the Statistical Abstract of the United States.

It may be noted that in the first year compared—1930—the per capita income in Illinois was $722 while the United States had an income of $596 for a total difference of $176. In 1960, income in Illinois increased to $2,613

[20] Byrne J. Horton, Julien Ripley, and M. S. Schnapper, *Dictionary of Modern Economics* (Washington, D. C.: Public Affairs Press, 1948), p. 255.

CHART 3
Per Capita Income in Illinois and United States



as the comparable figure for the United States increased to $2,223 which is $390 less than the income in Illinois. The lowest the per capita income during the years compared appears to have occurred in 1934 when $488 is recorded for Illinois and $420 is recorded for the United States. Here again the figure for Illinois is $68 higher than the figure for the United States.

The constant increase in income except during the depression years, is vividly shown in the preceding chart. As the review of the material indicates, the increase in per capita income may be expected to continue in both the State of Illinois and the United States. The effect of the rise in the cost of living will be reviewed in a later section of this chapter.

Enrollment and Percent in Elementary, Secondary, and Unit Districts in ADA

While progress has been made since 1945 in reducing the number of school districts, there has been little change since 1950 in the percentage of

TABLE 9

Total and Per Capita Income; Total Current Expense in Elementary and Secondary Schools; Illinois and United States; Selected Years

Years	Total Income (in millions) Illinois	U. S.	Per Capita Income Illinois	U. S.	Total Current Expense in Ele. and Sec. Schools (in thousands) U. S.	Illinois
1929-30 ..	$ 5,903	$ 73,325	$ 772	$ 596	$ 1,843,552	$123,431
1933-34 ..	3,787	53,038	488	420		
1937-38 ..	4,833	66,045	616	509		
1939-40 ..	5,740	75,852	727	575	1,941,799	125,879
1941-42 ..	8,267	117,196	1,042	876	2,067,660	133,647
1943-44 ..	10,297	153,306	1,341	1,161	2,293,337	150,281
1945-46 ..	12,160	170,962	1,463	1,212	2,707,441	167,321
1947-48 ..	15,002	202,385	1,722	1,387	3,794,702	245,678
1949-50 ..	15,400	217,828	1,826	1,491	4,687,274	280,073
1951-52 ..	17,681	255,367	2,095	1,727	5,722,162	333,122
1953-54 ..	19,751	285,329	2,174	1,770	6,790,923	381,164
1955-56 ..	22,857	330,380	2,440	1,975	8,251,420*	462,847
1957-58 ..	24,100	357,498	2,451	2,064	10,251,843*	544,950
1959-60 ..	26,425	400,002	2,613	2,223		

SOURCE: U. S. Office of Education, *Biennial Survey of Education in the United States*, (Washington, D. C.: Government Printing Office, 1929-30 to 1957-58); U. S. Department of Commerce, *Survey of Current Business*, Annual Income Number, (Washington, D. C.: Government Printing Office).

*Not entirely comparable with previous years.

ADA enrolled in the elementary, secondary, and combined unit districts. (Approximately 30% elementary, 10% high school and 60% unit).

The ADA enrollment data were based on the following calculations:

1. ADA enrollments were taken from the Annual Statistical Report of the Superintendent of Public Instruction, State of Illinois.

2. Percentages of total ADA were determined for the elementary, secondary, and unit districts.

3. Projected median total enrollments were established for the years 1961-62, 1969-70 according to the method and assumptions given in the school enrollment section.

4. Ratio between ADA and total enrollment was determined for the school year 1960-61. This ratio (92.3) will be assumed to prevail for the ADA projection. Total ADA for each school year was determined in this manner.

5. Total ADA enrollment was subdivided using the experience ratio of 1960-61; elementary districts (29.6), secondary districts (10.7), and unit districts (59.7).

Any prediction cannot be expected to be 100 percent accurate. The last years of the prediction must be accepted with some reserve. However, barring great social or economic changes, the research team believes the prediction will prove fairly reliable.

State Aid

State appropriations for public schools in Illinois originated in 1825. In 1855, a state property tax of two mills on each dollar of assessed valuation was enacted. This property tax legislation was in effect from 1855 to 1873, and produced from $600,000 to $900,000 annually. During the years 1873 to 1911 an annual appropriation of $1,000,000 plus six percent interest from a fund made up primarily from the sale of public land belonging to the United States.

Beginning in 1911, a state appropriation was made biennially. In 1959, the General Assembly appropriated $361,000,000 for school purposes. This sum represented an increase of approximately two and a half times the appropriation made in 1949.

State Distributive Fund

At present, there are four distinct appropriations for school purposes, the largest appropriation being made to the Common School Fund:

1. Common School Fund
2. Special Education
3. Vocational Education
4. Transportation

Basis for Making Claims

The basis for making claims is a combination of flat grants and equalization. A flat grant is made for each elementary and high school student in

TABLE 10

ADA Enrollment and Percent in Elementary, Secondary and Unit Districts — 1949-50 to 1969-70

Years	Elem. and One Room Teach. Dist.	Percent of Total ADA	Secondary Districts	Percent of ADA	Unit Districts	Percent of ADA	Total ADA
1949-50	305,563	29.2	102,583	9.7	639,134	61.0	1,047,280
1950-51	307,393	28.9	101,638	9.5	656,457	61.6	1,065,506
1951-52	307,711	28.3	101,368	9.3	674,958	62.3	1,084,037
1952-53	321,598	28.3	105,073	9.2	708,547	62.4	1,135,218
1953-54	343,422	28.6	109,795	9.1	748,645	62.3	1,201,862
1954-55	360,012	28.6	115,042	9.1	786,039	62.3	1,261,093
1955-56	377,610	28.8	121,726	9.3	809,879	61.8	1,309,215
1956-57	394,161	28.7	134,037	9.6	845,270	61.5	1,373,468
1957-58	401,892	28.7	144,918	9.6	966,727	61.5	1,513,537
1958-59	426,218	28.9	154,258	10.4	900,282	60.7	1,480,758
1959-60	444,061	28.9	156,708	10.4	898,777	60.7	1,499,567
1960-61	463,661	29.6	168,020	10.7	935,630	59.7	1,567,311
1961-62	475,646	29.6	173,110	10.7	969,090	59.7	1,617,846
1962-63	491,912	29.6	179,029	10.7	1,002,230	59.7	1,673,171
1963-64	511,425	29.6	186,131	10.7	1,041,984	59.7	1,739,540
1964-65	525,148	29.6	191,125	10.7	1,009,944	59.7	1,786,217
1965-66	535,372	29.6	194,846	10.7	1,090,774	59.7	1,820,992
1966-67	545,805	29.6	198,642	10.7	1,112,029	59.7	1,856,476
1967-68	555,482	29.6	202,165	10.7	1,131,746	59.7	1,889,393
1968-69	564,619	29.6	205,490	10.7	1,150,362	59.7	1,920,471
1969-70	571,814	29.6	208,109	10.7	1,165,023	59.7	1,944,946

SOURCE: Office of Public Instruction, State of Illinois, *Annual Statistical Report of the Superintendent of Public Instruction.* No. 14-142 (Springfield, Ill.: the Office, 1949-1960). Projection figures based on data compiled by the Director of Finance and Statistics, Office of Public Instruction, State of Illinois.

TABLE 11

State Appropriation for School Purposes, Selected Bienniums, 1911-1959

Biennium	Total	Biennium	Total	Biennium	Total
1911-13	$ 4,114,000	1927-29	$17,242,844	1943-45	$ 41,752,770
1913-15	6,114,000	1929-31	21,291,668	1945-47	54,929,816
1915-17	8,164,500	1931-33	22,299,879	1947-49	84,140,304
1917-19	8,384,598	1933-35	21,298,364	1949-51	124,247,752
1919-21	12,872,950	1935-37	28,120,694	1951-53	151,114,626
1921-23	17,023,068	1937-39	27,807,228	1953-55	173,566,865
1923-25	17,142,568	1939-41	32,715,000	1955-57	228,276,850
1925-27	17,242,568	1941-43	34,609,500	1957-59	247,038,000
				1959-61	361,000,000

SOURCE: Illinois School Problems Commission, Report No. 6, p. vi.

average daily attendance. In order to qualify for the equalization aid, a school district is required to levy a tax at a given rate for the operation of its schools. If the proceeds from the 100% collection of the tax and the flat grant are not enough to provide the equalization level for each pupil in average daily attendance, the state provides the difference in equalization aid. This basic plan was adopted in 1927 and has been in operation since 1928.

Present Status of the State Distributive Fund

Flat grants of $47 per resident elementary pupil and $32 for each high school student in average daily attendance are distributed to recognized schools. The equalization level guarantee is $252 per pupil in average daily attendance. Qualifying rates of $0.54 for elementary and high school districts, and $0.67 in unit districts are required per $100 of equalized assessed valuation.

An example of the "State Aid" formula for receiving state aid:

A tax levy of 54¢ in an elementary district produces only $175 per pupil in average daily attendance. The state will pay the difference of $77 to guarantee the $252 level. The flat grant portion will be $47 and equalizations will be $30.

The various changes in the State aid formula since 1928 are summarized in the following table.

With the passing of years flat grants, equalization and qualifying rates have changed. Flat grants in elementary districts in per pupil average

TABLE 12
Flat Grants, Equalization Level and Qualifying Rates (1927-59)

Year	Flat Grants Elem.	Flat Grants High	Equalization Elem.	Equalization High	Qualifying Rates Elem.	Qualifying Rates High	Unit
1927 ..	$ 9.00	$	$ 34.00	$	$1.00	$	$1.00
1935 ..	11.00		41.00		1.00		1.00
1939 ..	11.00		51.00	80.00	1.00	0.75	1.50
1941 ..	11.00		56.00	80.00	1.00	0.75	1.50
1943 ..	13.00	2.00	62.00	85.00	1.00	0.75	1.50
1945 ..	19.00	4.00	80.00	90.00	0.25	0.25	.375
1946 ..	25.00	10.00	80.00	90.00	0.25	0.25	.375
1947 ..	22.00	7.00	90.00	100.00	0.25	0.25	.375
1948 ..	22.00	7.00	120.00	120.00	0.25	0.25	.36
1949 ..	22.00	7.00	160.00	160.00	0.40	0.40	.50
1953 ..	22.00	7.00	173.00	173.00	0.40	0.40	.50
1955 ..	22.00	7.00	200.00	200.00	0.50	0.50	.62
1959 ..	47.00	32.00	252.00	252.00	0.54	0.54	.67
1961 ..	47.00	32.00	252.00	252.00	0.54	0.54	.67

SOURCE: Illinois School Problems Commission Report No. 6.

daily attendance have increased from $9.00 in 1927 to $47.00 in 1961. Flat grants per pupil in average daily attendance in high school districts have risen from $2.00 in 1943 to $32.00 in 1961. The equalization level in elementary districts and high school districts has also increased from the beginning rates of $34.00 and $80.00 respectively to $252.00 for both types of districts in 1961. Qualifying rates on the other hand have decreased from the 1927 rate of $1.00 for elementary and unit districts to $0.54 and $0.67 in 1961. High school districts have decreased from the $0.75 rate set in 1941 to $0.54 in 1961. The drop in the qualifying rates in 1945 accompanied a change in assessment levels to counteract it.

The changes in formula produced variances in the percent of flat grants and equalization grants required to meet school district claims. The changes are illustrated in the table, "State Aid Claims for Selected Years."

The greatest portion of the distributive fund is distributed to school districts by the "State Aid" formula described in Present Status of the State Distributive Fund. Before a distribution of the appropriation to school districts may be made, several claims must be paid. These are:

1. Tuition of children from orphanages and children's homes, or Veterans' hospitals or military encampment areas, or in State housing units.

2. Tax-equivalent grants to districts wherein State institutions are located.

3. Compensation of county superintendent and assistants.

4. Supervisory expense fund for county superintendents' offices.

5. Teachers' Retirement System.

Once these obligations are met the balance is apportioned to county superintendents throughout the state. School district claims are then paid from the county superintendents' offices.

TABLE 13

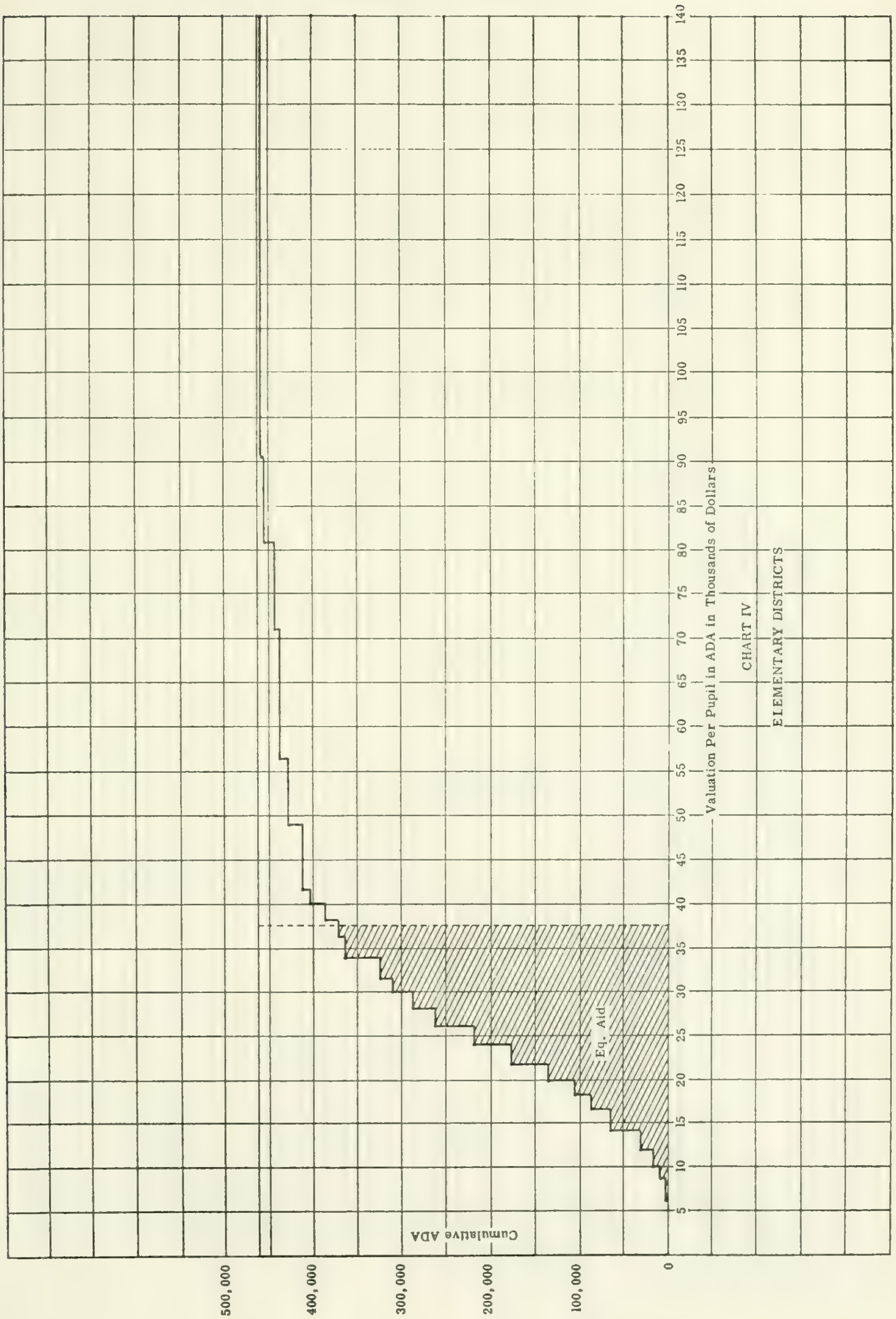
State Aid Claims for Selected Years

Year	Flat Grants	Equalization	Total	Percent of Flat Grant	Percent of Equalization
1931-32	..$ 8,373,992	$ 810,893	$ 9,184,815	91.2	8.8
1936-37	.. 9,669,338	1,645,615	11,314,953	85.5	14.5
1941-42	.. 8,248,992	4,028,130	12,299,122	67.2	32.8
1946-47	.. 13,816,556	5,462,968	19,279,524	71.7	28.3
1951-52	.. 19,132,565	33,370,107	52,502,672	36.4	63.6
1956-57	.. 24,855,310	68,604,048	93,458,358	26.6	73.4
1957-58	.. 25,408,518	68,709,443	94,117,961	27.0	73.0
1958-59	.. 27,170,683	70,411,666	97,582,349	27.8	72.0
1959-60	.. 65,439,968	89,354,702	154,794,670	42.3	57.7
1960-61	.. 67,746,311	88,904,218	156,650,529	43.2	56.8

SOURCE: Illinois School Problems Commission Report No. 6, p. 89.

CHART 4

Elementary Districts



Analysis of State Aid for the School Year 1960-61

A graphing procedure was developed in order to give a clear representation of the proportion of school districts which receive as well as those which do not receive aid. Average daily attendance is graduated in the left margin, vertically. Equalized assessed valuation is graduated along the bottom line horizonally. The vertical line indicates the basis for state aid claims on the elementary, high school, and unit district charts.

Elementary Districts

An elementary district with $37,963 or more equalized assessed valuation per resident pupil in average daily attendance does not qualify for special equalization aid because application of $0.54 per $100 of equalized assessed valuation will produce $205.

Example:

a. Equalization level minus Flat Grant equals Eqalization level of District Taxation $252.00 − $47.00 = $205.00

b. District Equalization Level divided by qualifying rate multiplied by Assessed Valuation equals Valuation Per Pupil required not to receive special equalization aid from the State
$205.00 ÷ $0.54 × $100 = $37,963

Several points may be observed from an analysis of the elementary district graph.

1. The total state equalization aid is represented by the cross hatched area left of the basic equalization line and the points indicating equalized assessed valuation of school districts.

2. A small proportion of elementary school districts do not claim equalization aid.

3. The majority of elementary school districts claim state aid.

4. The amount of equalization and aid to elementary school districts in 1960-61 was estimated as being $34,274,415.

High School Districts

A high school district with a equalized assessed valuation of $40,741 or more per resident pupil in ADA does not qualify for special equalization because the application of $0.54 per $100 of equalized assessed valuation will produce $220.

Example:

a. Equalization level minus Flat Grant equals Eqaulization Level of District Taxation $252 − $32.00 = $220.00

b. District Equalization Level divided by the qualifying rate equals Valuation Per Pupil required not to receive Special Equalization Aid from the State $220.00 ÷ $0.54 × $100 = $40,741

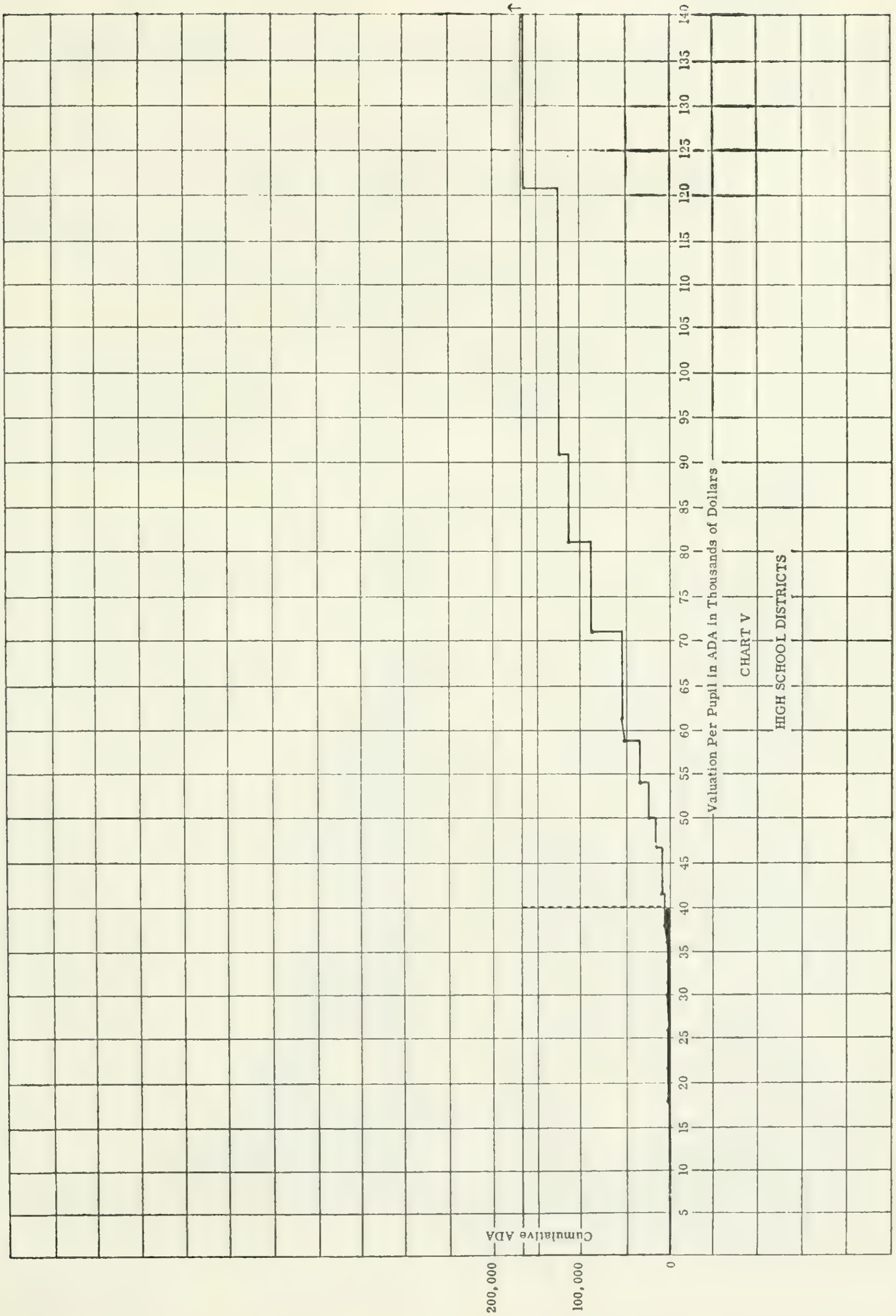
The high school district chart provides a pictorial view of these findings:

1. Very few high school districts receive special equalization funds.

2. Those districts which do receive equalization aid receive a small percentage of their funds from the state.

CHART 5

High School Districts



3. The amount of state equalization aid to high school districts in 1960-61 was estimated as being $432,169.

Unit Districts

An equalized assessed valuation of more than $31,157 per resident pupil in average daily attendance would eliminate any unit district from receiving special equalization aid.

Example:

a. Equalization Level minus Flat Grant equals Equalization Level of District Taxation $\$252 - \$43.25 = \$208.75$

b. District Equalization Level divided by Qualifying Rate equals Valuation Per Pupil required not to receive Special Equalization Aid from the State $\$208.75 \div \$0.67 \times \$100 = \$31,157$

The unit district graph shows these points:

1. Most unit districts receive special state equalization aid.
2. A small percentage of unit districts do not receive equalization aid.
3. Only a small number of unit districts appear prepared to finance schools without state support.
4. The amount of equalization aid to unit districts in 1960-61 was estimated as being $53,259,587.

Estimating Flat Grants

At the present time the state distributes to each recognized school district a flat grant of $32 per high school pupil and $47 per elementary pupil in average daily attendance. In addition the state allocates to each recognized elementary or high school district the amount of equalization aid by which its flat grant and the yield of a 54 cent local tax fails to reach $252 per pupil. The amount of equalization aid to each unit district is the amount by which its flat grant aid and the yield of a 67 cent local tax fails to equal $252 per pupil in average daily attendance.

If the amounts per pupil of the flat grants are not changed, it will be possible to estimate the amount required for the flat grants from the projected average daily attendance. The flat grants amount to $32 per high school pupil, $47 per elementary pupil, and $43.38 per pupil in unit districts, since their total ADA is 75.9 percent elementary and 24.1 percent high school.[21] Flat grants are an expensive way to finance a foundation program, because to the extent the state uses flat grants, it takes over the entire burden of support. Flat grants are recommended only when the state has more funds available than are necessary on a strict equalization basis, or there is some special condition to be met.

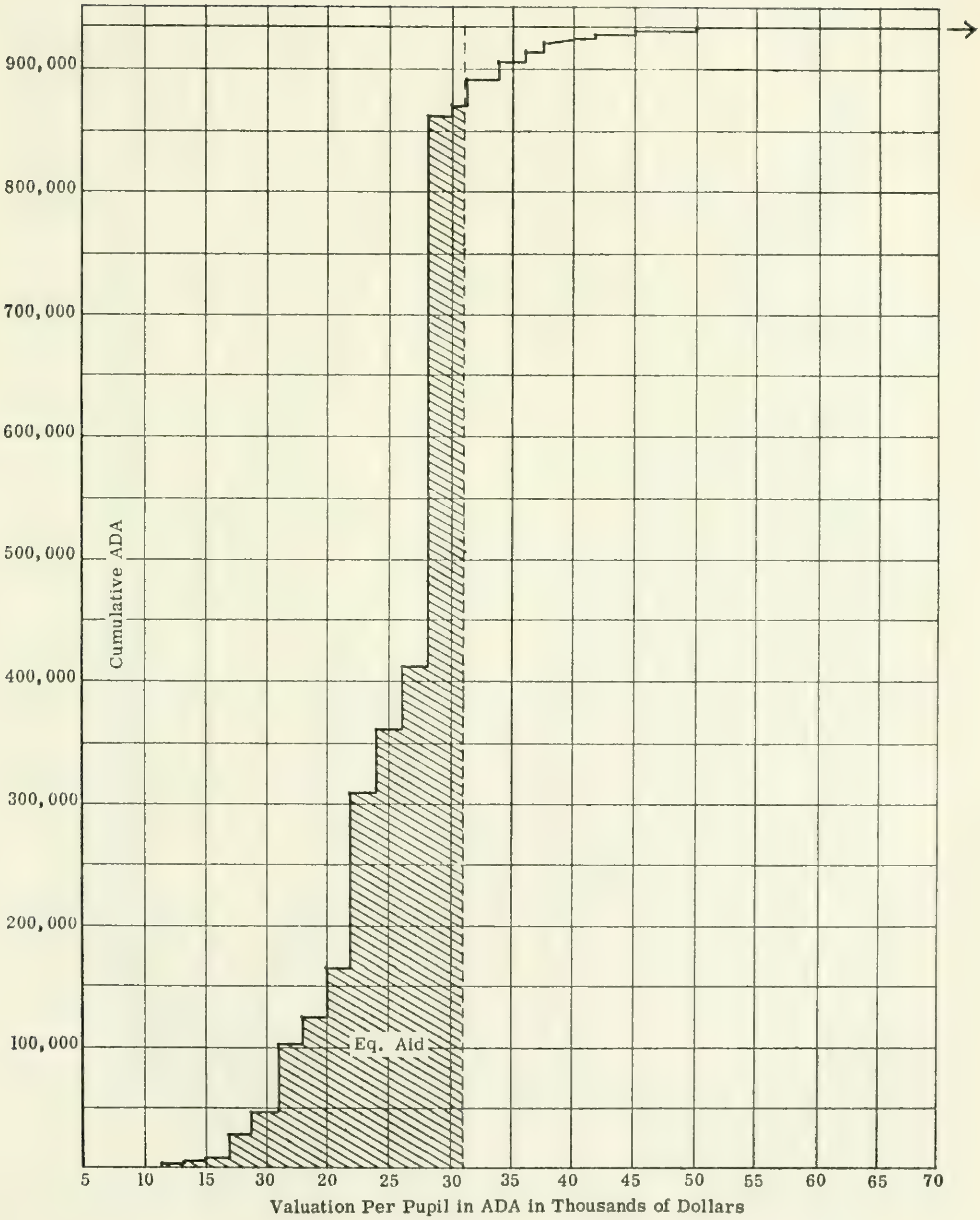
Estimating Equalization Aid

The amount required for equalization aid in any particular future year depends not only on the average daily attendance but also on the amount of the equalized assessed valuation, its distribution among the districts, the level of the program, and the required rate of local contributions.

[21] Derived from State Department data.

CHART 6

Unit Districts



The manner in which these factors work together can be seen in Chart 6, in which (reading from bottom upwards), the three classes of districts are presented in ascending order of valuation per pupil in average daily attendance. The number of pupils in each class of district at each valuation per pupil is measured on the vertical axis, beginning at the bottom and counting up. The valuation per pupil of each group of districts is measured on the horizontal axis. The scales for the unit districts and for the elementary and high school districts are adjusted to their respective rates of local contribution, 67 and 54 cents, so that in all three figures the one unit of distance represents $5.40. Because of this fact a line to indicate an income of $252 per pupil is at the same distance from the left vertical axis in all three figures.

At the left of each of the three figures is a cross hatched area of the proper width to represent the flat grants the districts receive. Since the vertical axis represents the number of pupils in ADA, the sizes of the shaded areas at the left represent the amounts of the flat grants.

It will be seen that the figure for unit districts starts at the bottom with districts which have an ADA of 100,000 with an average valuation of $5,000 to $15,000 per pupil — and so on.

The vertical lines at the right of the charts indicate the extent of the equalization program. For instance, in elementary districts with a flat grant of $47 there remains $205 to be raised from local taxes, or local taxes and equalization aid. With the required rate of local contribution at 54 cents per hundred dollars of valuation an elementary district which has a valuation of $37,963 per pupil in ADA has just enough valuation to supply the $205 required. The vertical line is set at that valuation, $37,963 and cuts the right boundary of the chart at a height of approximately 400,000 ADA on the vertical scale at the left. The districts above this point have more than enough valuation to finance $205 per pupil in ADA locally. The districts below this point do not have enough valuation. The clear portions of the three figures represent the amounts contributed locally to the equalized program, and the cross hatched portions on the right represent the amounts of equalization aid required.

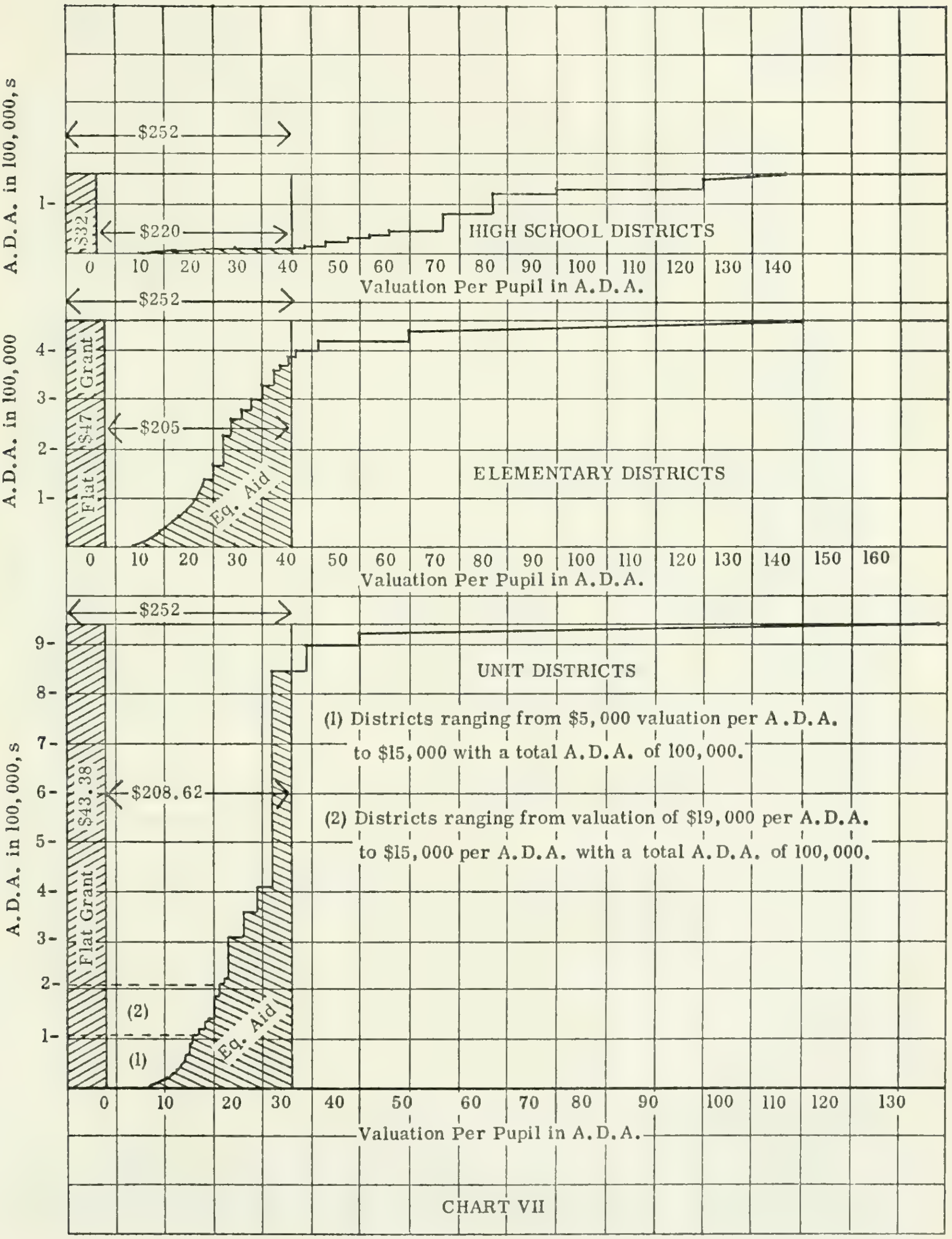
The estimates of the amounts of equalization aid required were made from the data from which the foregoing charts were made. The data were for the year 1960-61, and from them the amount of aid for any equalization program for that year could be computed. To estimate amounts of equalization aid in the future the assumption was made that the distribution of valuation in the state would remain constant. Under this assumption it was possible to take account of the expected growth in ADA and increase in valuation. The detailed procedure is presented in the appendix.

The Projected ADA

The number of pupils to be expected by years till 1970 have been estimated elsewhere in this study. Since almost all the children who will be in

CHART 7

Illinois School Districts Arranged in Descending Order According to Valuation Per A.D.A. to Indicate Distribution of State Distributive Fund, 1960-61



school in 1970 are already in the population these estimates are considered reliable.

Projecting the Equalized Assessed Valuation

The equalized assessed valuation of the state for the school years of the past decade increased by 43 percent in the decade 1950-1960, as can be seen in Table 14. This was in a period, as stated on page 72 of *The Report of the Illinois School Problems Commission No. 6,* in which:

> According to the best information available, valuations in 1948 were approximately 70 percent of true values, and this percentage has steadily decreased in the intervening years until by 1958 they were in the neighborhood of 50 percent. In spite of the fact that assessed valuations have steadily declined in relation to true values the totals have increased to a marked degree. Much of this is due to inflation, but the adding of new construction to the tax rolls has probably been a more significant factor.

An investigation of revenue sources for schools has found that in Illinois an increase of 1.0 percent in total income is related to .85 percent increase in property valuations.[22] It is estimated that the total income of the state is to increase by 50.31 percent from 1960 to 1970.[23] Eighty five hundredths times this percentage yields 42.76 percent. According to this calculation the assessed valuation of property in Illinois should increase by as high a percentage this decade as it did from 1950 to 1960 even though the cost of living should remain constant.

The reason that the projected valuation increases at a rate of 41 percent during this decade instead of 43 percent as in 1950-60 is that the latest assessed valuation of the state, 34.86 billions of dollars for the school year 1962-63 is low, and the projection was made from this value. It appears that a projection such as is shown in Table 14 is conservative if the ratio of assessed to true value is kept constant.

Notes and projections of Table 14:

Column (2) is from appropriate issues of the Biennial Survey of Education, Chapter 2. The projections in this column come from another part of this study.

Column (3) is obtained by multiplying Column 2 and Column 4. This gives the current expense for elementary and secondary schools, exclusive of the expenditure for the State Department, night schools, etc.

Column (4) comes from the Biennial Survey, Chapter 2. The projection of this column is on the basis that the percent of increase in the decade 1960-70 will be the same as in 1950-60.

Column (5) is from the Annual Reports of the Department of Revenue.

---

[22] McLoone, Eugene P. "Are School Revenue Sources Adequate for the 1960's?" *School Life* 44:12; September, 1961.

[23] Th total income of Illinois in 1960 was 26.42 billions of dollars. (Survey of Current Business, August, 1962, p. ii). The total income of Illinois in 1970 is estimated to be 39.52 billions of 1959 dollars. (National Planning Association, quoted in "Financing the Public Schools, 1960-70," Washington, D. C., *National Education Association*, p. 52). The cost of living was 1.015 times as much in 1960 as in 1959, so 39.52 billions of 1959 dollars are equivalent to 40.12 billions of 1960 dollars; 40.12 divided by 26.42 equals 1.5031 which indicates that in terms of constant 1960 dollars it is estimated that the total income of Illinois is to increase by 50 percent in this decade.

TABLE 14
Selected Data Pertaining to the Present and Prospective Level of Public School Support in Illinois

Year (1)	A.D.A. (2)	Total Current Expense (Thousands) (3)	Current Expense per pupil in A.D.A. (4)	Equalized* Assessed Valuations (Thousands) (5)	Total Personal Income (Millions) (6)	Per Cent Total Current Expense is of Total Personal Income (7)
1949-50	1,032,000	$ 226,731	$258.46	$22,386,013	$15,400	1.73
1951-52	1,084,035	315,974	291.48	23,130,087	17,681	1.79
1953-54	1,202,000	383,209	318.81	25,283,003	19,751	1.94
1955-56	1,309,214	462,780	353.48	26,134,106	22,857	2.02
1957-58	1,413,537	544,947	385.52	26,608,585	24,100	2.26
1959-60	1,499,567†	656,420	437.74‡	32,006,431	26,425	2.48
Percent Increase of 1959-60 over						
1949-50	45.3	146	69.36	43	71.59	43
Projections:						
1961-62	1,599,607	777,985	486.36§	34,323,000¶		
1963-64	1,739,540	940,030	540.39	36,179,215		
1965-66	1,820,992	1,093,360	600.42	40,578,927		
1967-68	1,889,393	1,260,451	667.12	43,717,198		
1969-70	1,944,946	1,441,866	741.34	45,240,019	49,000•	2.94
Percent Increase of 1969-70 over						
1959-60	29.7	120	69.36	41	85	14.5

SOURCES: See 52-A and 52-B.
SOURCES OF DATA:
*From the Annual Reports of the Department of Revenue. The assessed valuations are those used in connection with the attendance of the year indicated. For example, the school year 1949 50 used the valuation of 1948, and so on.
†Report of State Superintendent of Public Instruction, 1960, pp. 297-298.
‡"Estimates of Public School Statistics" 1960-61, Washington. National Education Association, p. 30.
§"Estimates of Public School Statistics, 1961-62, Washington. National Education Association, p. 30.
¶Actual data.
•Illinois income in 1970 estimated to be 39.52 billions of 1959 dollars by National Planning Associations as quoted in *"Financing the Public Schools,"* 1960-70, Washington, N.E.A., p. 52. If consumers' price index increases from 1960 to 1970 as from 1950 to 1960, this amount will be equivalent to 49 billion current 1970 dollars.

The projection is on the basis that the percent of increase in 1960-70 will be the same as in 1950-60. The figures in this column are the total figures for the valuation of the state, and are different from the sum of the valuations of the districts of the state, when the valuations in the elementary and high school districts are counted twice. It is also to be noted that the valuation for 1949-50 is the 1948 valuation and so on, because each school year is financed from a valuation of the year before it starts.

Column (6) comes from appropriate issues, usually August, of the Survey of Current Business. The projection comes from an estimate of the National Planning Association.

Column (7) is Column (3) divided by Column (6).

The projections in Columns (4), (5), and (6) are all on the basis that their increase in each case will be at the same rate as from 1950 to 1960, when the cost of living rose by 23.05 percent. The cost of living has risen since 1960 at a rate that will give an increase of approximately 11 percent for this decade. This is discussed in the last pages of this section of the study.

Projection of Levels of the Equalization Program

Current expense per pupil in average daily attendance rose from $258.46 in 1949-50 to $437.74 in 1959-60, an increase of 69.36 percent. One investigator has found that over the total period he studied, "A one percent change in per pupil expenditures is related to a one percent change in per capita income.[24] In the past decade per capita income in Illinois increased by only 43 percent[25] which was at the rate of 1.61 percent increase in current expense for each percent increase in per capita income.

In general a one percent increase in current expense to each percent increase in per capita income will make it possible for the schools to share proportionately in the general rise in well being, but does not provide leeway for expansion or improvement. It is evident that the nation has felt that schools have been receiving less than was desirable and expenditures for schools have been increasing more rapidly than the national income. Chart 8 shows the rise in expenditure per pupil in Illinois and the nation. Since it is anticipated that the average daily attendance will increase only 30 percent in this decade as compared with 45 percent from 1950 to 1960, and the per capita income in terms of constant dollars is expected to rise more rapidly during this decade than in the last it should be possible for the current expense per pupil to rise by as great a percent as in the last decade. An examination of Chart 8 reveals the regularity of the rise in current expense per pupil in Illinois and the U.S., and shows that the National Education Association estimates of expenditures per pupil for Illinois for the years 1960-61 and 1961-62 are above the trend line. For the purpose of the calculations of this study the assumption that current expense per

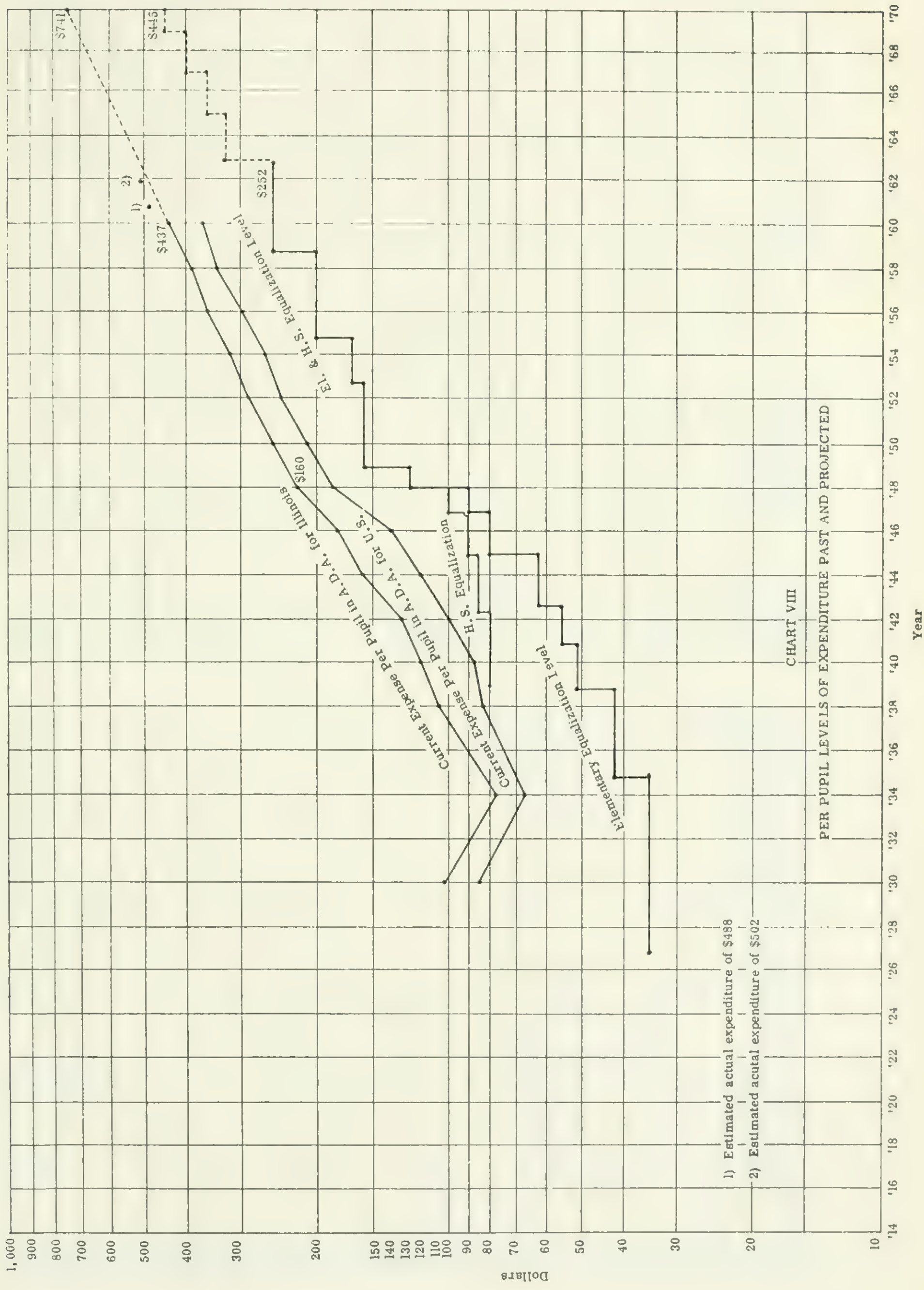
---

[24] McLoone, Eugene P., Effects of Tax Elasticities on Financial Support of Education. Doctoral Dissertation. University of Illinois, 1961. Microfilm, p. 141.

[25] Per capita income for Illinois was $1,826 in 1950 and $2,613 in 1960. *Survey of Current Business,* August, 1961.

CHART 8

Per Pupil Levels of Expenditures Past and Projected



pupil will increase by the same percentage in this decade as in the last seems best.

Table 15 shows that the level of the equalization program has been rising from 43.4 percent of the average per pupil expenditure of the State in 1941-42 to 61.9 percent in 1949-50 and 57.5 percent in 1959-60. It is important that the equalization level be kept in proper relation to the overall expenditure, for otherwise the schools in areas of low valuation per pupil will be left without proper support. Because of this consideration 60 percent was taken as the percentage for calculating the projected levels of the equalization program. It seems reasonable for the state to guarantee that expenditures in all districts shall be at least 60 percent of the average expenditure in the state, and this figure was adopted for the projection.

The level of the equalization program should ideally be equal to the cost of the minimum foundation program, the program that should be guaranteed in all districts by the state. The cost of this program was estimated to be $302 per pupil in elementary schools in 1958-59 by the School Problems Commission.[26] On the assumption that the cost of the minimum foundation should rise in the same proportion as the projected average cost per pupil in ADA, the minimum foundation should cost $357 for 1961-62, $397 for 1963-64 and $544 for 1969-70.[27] These amounts are to be compared to the $252 actually in force in 1961-62, and the steps of $324, $360, $400 and $445 for the present decade. An examination of Chart 8 will show how these levels compare with the projected rise in the overall current expense per pupil.

Determining the Rates of Local Contribution

The present required rates of contribution under the equalization program are 54 cents for elementary and high school districts and 67 cents for unit districts per 100 dollars of assessed valuation. In adjusting rates in the finance program presented, the following objectives were kept in mind: (1) No district is to receive less aid than it has been receiving. A district which receives less equalization aid under a program which essays to raise levels of equalization has a just ground for complaint. This means that the rate of contribution cannot be raised more than enough to enable the "key" district, the district which has just enough valuation to support the $252 equalized program without receiving equalization aid, to provide the new amount per pupil without receiving aid; (2) the program should cost as little in state funds as possible. This requires that the rate of contribution be as high as possible. The limit is the rate possible in the "key" district just discussed; (3) the rates of elementary and high school districts should be kept equal, as they have been for some time past, to keep down unnecessary friction. For the same and other reasons, the equalization levels of the three types of districts should be kept equal; (4) The rate required in unit dis-

[26] *Report of the School Problems Commission No. 6*, March, 1961, p. 91.
[27] Taking the expenditure of 1958-59 to be the average of the expenditures of 1957-58 and 1959-60, which is $411.63.

tricts should continue to be adjusted so that territory organized into separate elementary and high school districts will find it advantageous to form a unit district.

The rates determined by the preceding rules require the minimum amount of equalization. The series of programs with rates determined in this way, which can be said to be having the rate of local contribution rise approximately in the same proportion as the level of the program, can be called Series I as indicated in Chart 9. However, it is possible that there may be a desire to keep the rates of local contribution from rising as high as in Series I. Therefore a second series is presented in which the rates increase regularly from 54 to 67 cents at a level of $252 in 1959-60 to 81 and 100 cents at a level of $445 in 1960-70. This is Series II in Chart 9.

The Relationship of Growth in Equalized Assessed Valuation and the Amounts of Equalization Aid Required

The Series I and Series II estimates presented in Chart 9 and Table 16 have been made on the assumption that the equalized assessed valuation of the State will increase from 33,683 millions of dollars for the school year 1960-61 to 46,900 millions of dollars in 1970-71 as in Table 21, page 207. In

TABLE 15

Comparison of Current Expenditure per ADA and Levels of Equalization Program to 1959-60 and Projected to 1969-70

School Year	Level of* Equalization Program	Average Current Expense per Pupil in ADA	Per Cent Column (2) is of Column (3)
1941-42	$ 56.00	$128.99	43.4
1943-44	62.00	158.02	39.2
1945-46	80.00	175.11	45.7
1947-48	90.00	223.19	40.3
1949-50‡	160.00	258.46	61.9
1953-54	173.00	318.81	54.2
1955-56	200.00	353.48	56.5
1959-60	252.00	437.74†	57.5
PROJECTED:			
1961-62	252.00	486.36	51.8
1963-64	324.00	540.00	60.0
1965-66	360.00	600.00	60.0
1967-68	400.00	741.00	60.0
1969-70	445.00	741.00	60.0

SOURCE and NOTES:

*Level of elementary program used when elementary and high school levels differed.
†*Estimates of Public School Statistics, 1961-62.* Washington. National Education Association, p. 30.
‡$120 equalization program for 1948-49 not included because Office of Education figure for current expenses is not available for that year.

Series I, the required rates of local contribution increase from 54 cents and 67 cents to \$1.01 and \$1.26, while in Series II, the required rates increase from 54 cents and 67 cents to 81 cents and \$1.00. The amount of equalization aid varies from 101.0 millions of dollars in 1962-63 to 182.5 millions in 1970-71 in Series I.

It will be found that the valuation for the year 1969-70, 45,240 millions of dollars, is 41 percent more than the valuation of 32,006 millions of dollars for the year 1959-60 as shown in Table 14, page 191. This projection was made on the assumption that equalized assessed valuation will increase at approximately 3½ percent per year as in the 1950-60 decade.

However, there are certain indications that the assessed valuation of the State may not increase as rapidly during this decade as it did from 1949-50 to 1959-60. For instance, the actual equalized valuation of the State increased from 33,683 millions of dollars for the school year 1960-61 to 34,857 millions of dollars for 1962-63 which corresponds to a compound rate just under 1¾ percent per year.

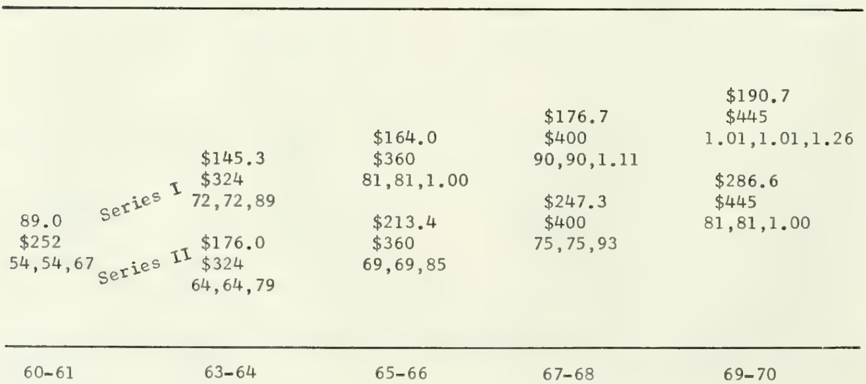
Series III estimates have been made on the basis that the rates of local contribution will be the same as in Series I, but that the assessed valuation will increase at a rate of 1¾ percent per year rather that at a rate of 3½ percent per year. In this series, the amount of equalization aid varies from 101.0 millions in 1962-63 to 280.9 millions in 1970-71.

It is entirely possible that the equalized valuation may increase even more slowly than this, but probably not, short of a depression or a change in the tax assessment policy of the State. Any slowing in the rate of increase of assessed valuation will require an increased amount of equalization aid.

The Series III estimates can be regarded as maximum and Series I

CHART 9

Schematic Presentation of the Amount of Equalization Required for Each of Several Programs, Showing for Each Program Its Amount of Equalization Aid in Millions, Level and Rates of Local Contributions



as minimum estimates under present tax assessment policies. If for any reason the total valuation of the State comes outside these maximum and minimum limits a greater or smaller amount of equalization aid will be required.

The Required Increases in Local Tax Rates

In 1963-64, the first year with the higher level of equalization in Series I, the rate for elementary and high school districts is 72 cents and for unit

TABLE 16

Projection of Amounts of Equalization Aid, Flat Grants and Total Aid Required for Certain Levels of Equalization and Required Local Rates, for School and Legislative Years 1962-63 to 1970-71

School Year	Level	Required Elem. H.S.	Rate Unit	Equalization Aid (Millions)	Flat Grant Aid (Millions)	Total Distributive Aid (Millions)	Distributive Aid for Legislative Year* (Millions)
SERIES I, with valuation increasing at 3½ percent per year							
1962-63	$252	.54	.67	$101.0	$72.3	$173.3	
1963-64	324	.72	.89	145.3	75.2	220.5	$197.9
1964-65	324	.72	.89	146.3	77.2	223.5	222.9
1965-66	360	.81	1.00	164.0	78.7	242.7	233.1
1966-67	360	.81	1.00	161.4	80.3	241.7	242.2
1967-68	400	.90	1.11	176.7	81.7	258.4	250.1
1968-69	400	.90	1.11	174.6	83.0	257.6	258.0
1969-70	445	1.01	1.26	190.7	84.1	274.8	266.2
1970-71	445	1.01	1.26	182.5	85.2	267.7	271.2
SERIES II, with valuation increasing at 3½ percent per year							
1962-63	$252	.54	.67	$101.0	$72.3	$173.3	
1963-64	324	.64	.79	176.0	75.2	251.2	$212.2
1964-65	324	.64	.79	176.3	77.2	253.5	252.3
1965-66	360	.69	.85	213.4	78.7	292.1	272.8
1966-67	360	.69	.85	212.2	80.3	292.5	292.4
1967-68	400	.75	.93	247.3	81.7	329.0	310.8
1968-69	400	.75	.93	247.5	83.0	330.5	329.7
1969-70	445	.81	1.00	286.6	84.1	370.7	350.6
1970-71	445	.81	1.00	280.9	85.2	366.1	379.5
SERIES III, with valuation increasing at 1¾ percent per year							
1962-63	$252	.54	.67	$101.0	$72.3	$173.3	
1963-64	324	.72	.89	151.2	75.2	226.4	$199.9
1964-65	324	.72	.89	156.6	77.2	233.8	230.1
1965-66	360	.81	1.00	181.8	78.7	260.5	247.2
1966-67	360	.81	1.00	185.9	80.3	266.2	263.4
1967-68	400	.90	1.11	218.6	81.7	300.3	283.3
1968-69	400	.90	1.11	226.7	83.0	309.7	305.0
1969-70	445	1.01	1.26	249.2	84.1	333.3	321.5
1970-71	445	1.01	1.26	250.4	85.2	335.6	334.4

*The last half of aid for school year 1962-63 and the first half of aid for school year 1963-64 will be paid in the legislative year 1963-64 and so on.

districts 89 cents. It is of interest to note that according to Table 12 on page 80 of Report of the *School Problems Commission No. 6,* the total average daily attendance in elementary districts which would have to raise their rate is 54,445. In high school districts the ADA number is 63. In unit districts the total ADA is probably less than 3,000. This makes a total of approximately 57,508 in ADA in districts which would have to raise their rates, or 4 percent of the public school population of the State. The amount of increase to reach the new rate is usually less than 10 cents. This seems to be a negligible amount of required increase in tax rates.

To reach rates of 81 cents, 81 cents and $1.00 as indicated for 1965-66, would require raising the rates in elementary, high school, and unit districts with 96,203; 380; and 7,487 in average daily attendance. This would make a total of 103,870 pupils in districts required to raise rates to qualify for new aid, or 7.3 percent of the average daily attendance of the State. The rates of .81 cents and 1.00 are rather high for equalization rates but are very much below the average rates of the school districts of the State. If, when the time to raise the level of equalization comes, it is decided that the rates indicated are too high, it will be possible to use lower rates by increasing the amount of equalization aid.

The Possible Variations from Predicted Expenditures

These estimates have been made on the assumption that the average current expense per pupil will rise during the present decade at the same rate as they did in the past one. One thing that can be counted on is change. During the 1950-60 decade the consumer's price index increased by 23.05 percent. In spite of the fact that the increase in the cost of living rose more slowly in the United States than in any leading European nation, some way to maintain prosperity and full employment without continually decreasing the value of the currency is greatly needed. If the cost of living remains stable, or increases at a rate of 1¾ percent per year or 19 percent per decade, as it has during the past two years, the growth of dollar expenditures for schools, equalization levels and the amounts of equalization aid required will no doubt be slowed. If the people of Illinois show through the actions of their school boards that they consider the level of school support to be high enough, the rise of levels of equalization will be slowed. However, no matter what happens, disparities between the high valuation and low valuation districts should be decreased rather than allowed to increase.

Illinois supplies a smaller proportion of public school support from State funds than most states, 20.5 percent. The average for the nation is 39.6[28] percent. Illinois ranks 43 in this regard. It may be advisable to increase this percentage, but only in such a way as to insure that no areas are left with schools that are left behind.

The Effect of Reorganization on the Amount of Equalization Aid

If there is renewed activity in the reorganization of elementary and

[28] *Biennial Survey of Education,* 1957-58, Chapter 2, p. 50.

high school districts into unit districts, the amount of equalization aid required will increase. It is estimated that if in 1960-61 all elementary and high school districts have been reorganized into unit districts, the additional amount of equalization aid required for $252 level program at rates of .54 .54, and .67 would have been 15.5 millions of dollars.

If the rates should rise proportionately with the level of the program (Series I in Chart 9), the additional amounts of aid required for the years 1963-64, 1965-66, 1967-68, and 1969-70 would be 22.4, 24.2, 27.1, and 28.5 millions of dollars respectively. If the rate of local contribution should rise gradually to .81, .81, and $1.00 in 1969-70, the additional amounts of aid for the years above would be 25.5, 30.0, 34.3, and 38.0 millions of dollars respectively.

The Effect of the Elimination of Flat Grants on the Amount of State Aid

The question has sometimes been raised as to how much State aid could be saved by eliminating flat grants. Maintaining the same level of program and rates of contribution as in Series I but eliminating flat grants, would decrease the total amount of State aid required in the years 1963-64, 1965-66, 1967-68, and 1969-70 by 9.9, 9.6, 11.8, and 13.8 millions of dollars respectively. For Series II, the decrease for the same years would be 7.2, 7.3, 9.0, and 8.3 millions respectively.

This would be a saving of about 5 percent of the total amount of aid for Series I, and less for Series II. The districts which receive only the flat grants have come to count on them; they pay taxes, moreover, they supply funds for equalization. Experience in other states has shown that it is best to leave such aids undisturbed, especially since their relative importance decreases as time goes on, and it is good to have every district in the State feel that it is an integral part of the State educational system.

SUMMARY

Total births have grown steadily in Illinois. This fact combined with higher survival rates among the infant population has led to a marked increase in the number of pre-school and school age children. On the basis of the results of the enrollment projections probably the best general statement concerning enrollment increases is that by the school year 1969-70 approximately 415,000 more pupils may be expected to be enrolled in public schools, when compared to the base year 1960-61.

Enrollment increases are not always equally distributed throughout the State. With the anticipated enrollment increase and migration to urbanized areas, the school districts in suburban and rural-urban fringe areas will be hard pressed to provide adequate educational opportunities for all.

It is interesting to note the lower percent of pupils transported in Illinois as compared to the national percent. In the school year 1959-60 the United States figure was 33.6 while in Illinois the percent was 25.1. By 1969-70, it is expected that 675,000 pupils in average daily attendance will

use buses daily. However, this number may be changed radically if new policies are adopted.

Ten years ago, several states had only minor programs for handicapped children. The State of Illinois, recognizing the incidence factors, permits school districts to establish programs. Even with many programs underway it is apparent that new efforts need to be made to expand special education programs on both the district and state levels. Estimates based on minimal percents of incidence indicate that at the present time only one-third of the children who need special education are receiving help.

There has been a trend toward more regular attendance of pupils enrolled in recent years. The United States percentage in average daily attendance reached 90.2 for 1959-60. The data for Illinois shows figures over 2% higher than the national average, 92.3 percent in 1959-60.

Drop-outs are a serious problem in Illinois as elsewhere. While pupils generally stay in school at least to the extent required by law, some pupils drop out even before completing eighth grade.

Perhaps one of the most significant changes in public school enrollment between 1940 and 1960 was the sharp increase in the number of kindergarten pupils. The kindergarten enrollment in Illinois rose from 45,988 in 1940 to more than 160,768 in 1960. Kindergarten enrollment is expected to continue to increase.

Nations with high educational development, though lacking in natural resources, have frequently raised themselves to positions of high economic status. On the other hand, some nations rating high in natural resources but with low economic status, such as Colombia, suffer seriously from a lack of trained personnel. It is thought that a relationship between educational development and per capita income exists. The human element should be of vital concern to those interested in the economic welfare of Illinois.

The basis for making State aid claims for schools in Illinois is a combination of flat grants and equalization. A flat grant is made for each elementary and high school student in average daily attendance. In order to qualify for the equalization aid, a school district is required to levy a tax at a given rate. If the proceeds from the 100% collection of the tax and the flat grant are not enough to provide the equalization level for each pupil in average daily attendance, the State provides the difference in equalization aid. For example, if a tax levy of 54 cents per $100 of assessed valuation in an elementary district produces only $175 per pupil in average daily attendance, the State will pay the difference of $77 to guarantee the $252 level. The flat grant portion will be $47 and equalization will be $30.

The amount required for equalization aid in any particular future year depends not only on the average daily attendance, but also on the amount of the equalized assessed valuation, its distribution among the districts, the level of the program, and the required rate of local contribution.

Estimates of the total amount of equalization aid required in elemen-

tary, secondary, and unit districts were made. The data were for the school year 1960-61, and from them the amount of aid for any equalization program for any year could be computed.

In general a one percent increase in current expense for each percent increase in per capita income will make it possible for the schools to share proportionately in the general rise in well being, but will not provide leeway for expansion or improvement. It is evident that the nation has felt that schools have been receiving less than was desirable and as a result, expenditures for schools have been increasing more rapidly than the national income. Since it is anticipated that the ADA will increase only 30 percent in this decade, as compared with 45 percent from 1950 to 1960, and the per capita income in terms of constant dollars is expected to rise more rapidly during this decade than in the last, it should be possible for the current expense per pupil to increase by as great a percent as in the last decade.

On the assumption that the cost of the minimum foundation should increase in the same proportion as the projected average cost per pupil in ADA the proposed minimum foundation level should be $357 for 1961-62, $397 for 1965-66, and $544 for 1969-70. These amounts are to be compared to the $252 actually in force in 1961-62 and the steps of $324, $360, $400, and $445 projected for the present decade. A detailed projection of the amounts of equalization aid, flat grants, required local rates, and total aid required for certain levels of equalization are presented in Table 16. If there is renewed activity in the reorganization of elementary and high school districts into unit districts, the increased amounts of equalization aid required are indicated.

TABLE 17
Projection 1 — Conservative

Grade	1960-61	Mean Ret. Rate (3 yrs.)	61-62	62-63	63-64	64-65	65-66	66-67	67-68	68-69	69-70
K	163,956 / 81,978		170,663 / 85,332	177,360 / 88,680	174,485 / 87,243	178,320 / 89,160	177,494 / 88,747	177,360 / 88,680	177,360 / 88,680	177,360 / 88,680	177,360 / 88,680
1	183,099		187,438	195,112	202,768	199,482	203,866	202,922	202,768	202,768	202,768
2	156,803	86.720	158,784	162,546	169,201	175,840	172,991	176,793	175,974	175,840	175,840
3	154,261	97.885	153,487	155,426	159,108	165,622	172,121	169,332	173,054	172,252	172,121
4	149,335	98.079	151,298	150,539	152,440	156,052	162,440	168,815	166,079	169,730	168,943
5	139,770	98.668	147,346	149,283	148,534	150,410	153,973	160,276	166,566	163,867	167,469
6	137,500	98.958	138,314	145,811	147,728	146,986	148,843	152,369	158,606	164,830	162,160
7	135,414	98.774	135,814	136,618	144,023	145,917	145,184	147,018	150,501	156,662	162,809
8	135,346	97.112	131,503	131,892	132,673	139,864	141,703	140,991	142,772	146,155	152,138
9	130,801	112.107	151,732	147,424	147,860	148,736	156,797	158,859	158,061	160,057	163,850
10	107,112	93.315	122,057	141,589	137,569	137,976	138,793	146,315	148,239	147,495	149,357
11	97,922	88.791	95,106	108,376	125,718	122,149	122,510	123,236	129,915	131,623	130,962
12	90,765	87.989	85,431	83,683	95,359	110,618	107,478	107,795	108,434	114,311	115,814
½K	1,700,106		1,743,642	1,796,979	1,850,224	1,888,812	1,915,446	1,943,401	1,969,649	1,994,270	2,012,911
Total	1,782,084		1,828,974	1,885,659	1,937,467	1,977,972	2,004,193	2,032,081	2,058,329	2,082,950	2,101,591

TABLE 18
Projection 2 — Expected

Grade	1960-61	Md. Ret. Rate (5 yrs.)	61-62	62-63	63-64	64-65	65-66	66-67	67-68	68-69	69-70
K	163,956		172,178	178,934	176,034	179,903	179,070	178,934	178,934	178,934	178,934
	81,978		86,089	83,467	88,017	89,952	89,535	89,467	89,467	89,467	89,467
1	183,099		187,438	198,212	205,989	202,650	207,105	206,145	205,989	205,989	205,989
		87.563									
2	156,803		160,327	164,126	173,560	180,370	177,446	181,347	180,507	180,370	180,370
		99.088									
3	154,261		153,373	158,865	162,629	171,977	178,725	175,828	179,693	178,861	178,861
		98.609									
4	149,335		152,115	151,240	156,655	160,367	169,585	176,239	173,382	177,194	176,374
		99.399									
5	139,770		148,437	151,201	150,331	155,714	156,403	168,566	175,180	175,340	176,129
		99.497									
6	137,500		139,067	147,690	150,441	149,575	154,903	158,601	167,718	174,299	171,473
		99.523									
7	135,414		136,844	138,404	146,986	149,723	148,862	154,164	157,845	166,918	173,468
		97.598									
8	135,346		132,161	133,557	135,080	143,455	146,126	145,286	150,461	154,054	162,909
	(1,273,506)	113.076	(1,295,851)	(1,326.762)	(1,369,688)	(1,403,783)	(1,431,690)	(1,455,643)	(1,480,242)	(1,499,492)	(1,578,040)
9	130,801		153,044	149,442	151,021	152,743	162,213	165,223	164,284	170,135	174,198
		93.823									
10	107,112		122,721	143,590	140,211	141,692	143,308	152,193	155,017	154,136	159,626
		89.129									
11	97,922		95,468	109,380	127,980	124,969	126,289	127,729	135,648	138,165	137,380
		87.547									
12	90,765		85,728	83,579	95,759	112,043	109,406	110,562	111,822	118,756	120,957
	(426,600)		(456,961)	(485,991)	(514,971)	(531,447)	(541,216)	(555,707)	(566,771)	(581,192)	(592,161)
½K	1,700,106		1,752,812	1,812,753	1,884,659	1,935,230	1,972,906	2,011,350	2,047,013	2,080,684	2,107,201
Total	1,782,084		1,838,901	1,896,220	1,972,676	2,025,182	2,062,441	2,100,885	2,136,480	2,170,151	2,196,668

TABLE 19
Projection 3 — Liberal

Grade	1960-61	Trend (6 yrs.)	61-62	62-63	63-64	64-65	65-66	66-67	67-68	68-69	69-70
K	163,956 / 81,978		172,958 / 86,089	182,131 / 91,066	181,526 / 90,763	187,915 / 93,958	189,289 / 94,645	192,712 / 96,356	195,110 / 97,555	197,510 / 98,755	199,909 / 99,955
1	183,099		187,438	202,688	210,641	207,227	211,782	210,801	211,782	211,782	211,782
		89.888									
2	156,803		164,584	168,484	182,192	189,341	186,272	190,367	189,485	190,367	190,367
		99.401									
3	154,261		155,864	163,598	167,475	181,101	188,207	185,156	189,227	188,350	189,227
		99.040									
4	149,335		152,780	154,368	162,028	165,867	179,362	186,400	183,379	187,410	186,542
		99.399									
5	139,770		148,438	151,862	153,440	161,054	164,870	178,284	185,280	182,277	186,284
		99.479									
6	137,500		139,042	147,665	151,071	152,641	160,215	164,011	177,355	184,315	181,327
		99.769									
7	135,414		137,182	138,721	147,324	150,722	152,288	159,845	163,632	176,945	183,889
		97.598									
8	135,346		132,161	133,887	135,389	143,785	147,102	148,630	156,006	159,702	172,695
		113.076									
9	130,801		153,044	149,442	151,394	153,093	162,586	166,337	168,065	176,405	180,585
		92.904									
10	107,112		121,519	142,184	138,838	140,651	142,230	151,049	154,534	156,139	163,887
		88.498									
11	97,922		94,792	107,151	125,372	122,422	124,020	125,413	133,189	136,262	137,677
		88.020									
12	90,765		86,191	83,436	93,808	109,759	107,177	108,576	109,795	116,603	119,292
½K	1,700,106		1,759,124	1,834,552	1,909,735	1,971,621	2,020,756	2,071,225	2,119,284	2,165,312	2,203,509
Total	1,782,040		1,845,213	1,925,618	2,000,498	2,065,579	2,115,401	2,167,581	2,216,839	2,264,067	2,303,464

Methods of Estimating Amounts of Equalizzation Aid Required

Estimates for base year:

1. Arrange the data for districts by class of district.
2. Record the ADA and total valuation of each district.
3. Find the valuation per pupil in ADA of each district.
4. Arrange the districts in each class of district in ascending order according to valuation per pupil in ADA.
5. Add the ADA and valuation of the districts of each class of district to obtain cumulative totals.
6. Make a table such as the following:

TABLE 20
Cumulative Totals of ADA and Valuation of Districts Arranged by Type and in Ascending Order According to Valuation Per Pupil in ADA, 1960-61

Districts with Valuations per ADA at or below (in thousands)	Cumulative Totals					
	Unit		Elementary		High School	
	ADA	Val. (Millions)	ADA	Val. (Millions)	ADA	Val. (Millions)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
$400	935.629	21,345.3	463,661	12,288.8	168,020	12,221.2
140	935.629	21,345.3	463,180	12,160.5	165.471	11.817.5
71	934,042	21.187.8	457,187	11,680.9	87.594	4,840.7
47	932,963	21,118.7	428.502	10.198.7	20.701	788.4
45	930.969	21.027.8	425,972	9.901.3	18.668	695.6
43	930,077	20,989.3	424,566	9.839.4	15.613	561.1
41	927.256	20,880.2	414,782	9,519.0	10.757	358.2
39	924,060	20,744.9	401,489	8,894.5	8,274	258.1
37	921,420	20,644.2	393 223	8,581.8	6,681	198.5
35	911,875	20,305.2	374,269	7,907.8	3,943	106.5
33	904,618	20,061.5	363.480	7,532.5	3,768	95.0
31	894,336	19.733.9	336.807	6,675.3	2,657	58.9
29	871,658	19.040.8	310,110	5,873.8	1,650	28.8

Read the bottom line as follows: At or below a valuation of 29 thousand dollars there are unit districts with a total ADA of 871,658 and a total valuation of 19,040.8 millions of dollars; elementary districts with a total ADA of 310,110 and a total valuation of 5,873.8 millions of dollars; and high school districts with a total ADA of 1650 and a total valuation of 28.8 millions of dollars.

7. Compute amount of equalization aid required for 1960-61 as follows:

Since the flat grants for elementary, high school, and unit districts are $47, $32, and $43.38 per pupil in ADA respectively, the amounts remaining to be guaranteed under the equalization program are $205, $220, and $208.62.

Since the required rate for elementary districts is 54 cents per hundred dollars, the valuation per ADA of the key elementary district is \$37,963. [205 ÷ .54 × 100 = \$37,963]. Any elementary district with a valuation per ADA less than \$37,963 will require equalization aid. Similarily, the valuations per pupil in ADA of the key high school and unit districts are \$40,741 and \$31,194 [220 ÷ .54 × 100 = \$40,741 and 208.62 ÷ .67 × 100 = \$31,137].

The elementary districts with a valuation per ADA less than \$37,963 will require equalization aid. Consulting Table 20 it is found that the nearest value to 37,963 in column (1) is 37 (thousands). The number of pupils in ADA in elementary districts requiring aid is 393,223 and their total valuation is 8,581.8 millions of dollars. The cost of 393,223 pupils at \$205 per pupil is \$80,610,715. The local contribution of these districts is \$46,341,720. (.54 × 8,581,814,000 ÷ 100). Therefore, the amount of equalization aid required is \$34,268,919. (\$80,610,715 — \$46,341,796).

The valuation of the key high school districts is \$40,741, and the total ADA and valuation of the high school districts which receive equalization aid are \$10,757 and 358.2 millions of dollars respectively as can be seen in Table 20 at the valuation 41 thousands. Therefore, the amount of equalization aid will be [(200 × 10,757) — (.54 × 358,200,000 ÷ 100)] = (2,366,-540 — 1,934,280) = \$432,260.

Similarly the valuation per ADA of the key unit district is \$31,137, and according to Table 20 at the valuation of 31 thousands per ADA the total ADA of the unit districts receiving equalization aid is 894,336 and their total valuation is 19,733.9 millions of dollars. The estimated equalization aid is therefore \$54,251,926. [(894,336 × 208.62) — (.67 × 19,733,900,000 ÷ 100) = 186,576,376 — 132,217,130 = 54,359,246].

There are certain errors of estimate involved in the foregoing calculations, and if a school is not recognized, its aid is cut off. The amounts of aid distributed for the year 1960-61 are now available from the State Department. The comparison of the estimated and actual amounts of equalization aid is as follows:

	Estimated	Actual
Elementary districts	\$34,268,919	\$34,227,665
High school districts	432,260	325,938
Unit districts	54,359,246	54,335,880
Total	\$89,060,425	\$88,889,483

The difference between the two amounts, \$170,942, is .2 percent of the total amount.

In order to estimate the amount of equalization aid for a future year, it is necessary to make certain assumptions. In the present case, these assumptions are that the distribution of average daily attendance and equal-

ized valuation between the classes of districts and within the classes of districts remains constant, and that estimates of ADA and valuation are available.

Table 21 gives the estimates for Illinois used in this study.

TABLE 21
ADA and Valuation Indexes
1960-61 to 1970-71

Year	Estimated		Ratio of year to 1960-61 in		
	ADA*	Equalized† Valuation (Millions)	ADA (k)	Total Valuation	Valuation per ADA (P)‡
(1)	(2)	(3)	(4)	(5)	(6)
On basis that equalized valuation increases at rate slightly over 3½ percent per year as in past decade:					
1960-61	1,567,311	$33,683	1.0000	1.0000	1.0000
1961-62	1,617,846	34,323	1.0320	1.0190	.9872
1962-63	1,673,171	34,857	1.0675	1.0349	.9695
1963-64	1,739,540	36,179	1.1099	1.0741	.9677
1964-65	1,786,217	37,553	1.1397	1.1149	.9782
1965-66	1,820,992	38,978	1.1619	1.1572	.9959
1966-67	1,856,476	40,457	1.1845	1.2011	1.0140
1967-68	1,889,393	41,993	1.2055	1.2467	1.0342
1968-69	1,920,471	43,164	1.2253	1.2815	1.0458
1969-70	1,944,946	45,240	1.2409	1.3431	1.0824
1970-71	1,969,640	46,900	1.2567	1.3924	1.1080
On basis that equalized valuation increases at rate of 1¾ percent per year as it has increased from 1960-61 to 1962-63 in this decade:					
1960-61	1,567,311	$33,683	1.0000	1.0000	1.0000
1961-62	1,617,846	34,323	1.0320	1.0190	.9874
1962-63	1,673,171	34,857	1.0675	1.0349	.9695
1963-64	1,739,540	35,482	1.1099	1.0534	.9491
1964-65	1,786,217	36,105	1.1397	1.0719	.9405
1965-66	1,820,992	36,735	1.1619	1.0906	.9386
1966-67	1,856,476	37,378	1.1845	1.1097	.9368
1967-68	1,889,393	38,031	1.2055	1.1291	.9366
1968-69	1,920,471	38,698	1.2253	1.1489	.9376
1969-70	1,944,946	39,375	1.2409	1.1690	.9421
1970-71	1,969,640	40,063	1.2567	1.1894	.9464

*From Table 10, p. 36.
†Valuations for 1960-61, 1961-62, and 1962-63 are actual valuations from State Department of Revenue. Other values are estimated.
‡Column (6) equals Column (5) divided by Column (4).

Let the amount of equalization aid for any year be represented by E, with a subscript at the left to denote the level of the program and a subscript at the right to indicate the rate of local contribution, the whole enclosed in a parenthesis with a subscript to denote the year. Thus the program in force during 1960-61 would be denoted by $(252^{E}\ r')$ '60-61, where r' represents the three rates 54, 54 and 67 cents; and E represents the sum of the aid in all three classes of districts. Let f stand for a future year for which an estimate is to be made. Let K be the ratio of the ADA of the future year to the base year, and p be the ratio of the valuation per ADA of the future year to that of the base year. Let 1 represent the level of the program to be estimated for the future year, f represent the future year, and b the base year. The formula is:

$$\left[{}_{1}\overset{E}{\ }\ {}_{r} \right]_{f} = k \left[{}_{1}\overset{E}{\ }\ {}_{pr} \right]_{b}$$

Suppose it is desired to estimate the cost of an equalization program at a level of \$445 at rates of \$1.01, \$1.01, and \$1.26 for elementary, high school, and unit districts for the year 1970-71, the flat grants remaining constant. The formula becomes

$$\left[{}_{445}\overset{E}{\ }\ {}_{r} \right]_{70\text{-}71} = K \left[{}_{445}\overset{E}{\ }\ {}_{pr} \right]_{'60\text{-}61}$$

By reference to Table 21, it will be found that for 1970-71

$$P = 1.1080,\ pr = 1.1080 \times \begin{matrix} 1.01 \\ 1.01 \\ 1.26 \end{matrix} = \begin{matrix} 1.1191 & \text{(elementary)} \\ 1.1191 & \text{(high school)} \\ 1.3961 & \text{(unit)} \end{matrix}$$

and K = 1.2567. By the method described in the section above, it is found that the equalization aid required for a \$445 program at rates \$1.1191, \$1.1191, and \$1.3961 in 1960-61 is \$145.2 millions. That amount multiplied by 1.2567 gives \$182.5 millions.

The proof of the formula used above, which is not given here, is based on the fact that when the distribution of valuation among districts remains constant, doubling the valuation has the same effect on the amount of local contribution, and hence on the amount of equalization aid, as doubling the rate, and vice versa. An informal explanation is that if it is estimated that the valuation per pupil in average daily attendance will increase by 25 percent, with the number of pupils in ADA remaining constant, the amount of aid required in the future year will be the same as the amount for a program in the base year at the same level and at rates 25 percent greater than the rates to be used in the future year. If the further consideration is added that the ADA is to increase by 30 percent, then the amount just arrived at in the step above must be increased by 30 percent. This is the estimated amount of equalization aid required in the future year.

CHAPTER IV

HIGHER EDUCATION

By William P. McLure*

Introduction

This chapter presents certain estimates relating to costs of public higher education in the decade from 1960 to 1970. Like other projections in this study, these estimates are based on assumptions from which three levels are prepared: low, medium, and high. The prognosis thus represents a range of expectations which seems reasonable to anticipate in the formation of long-range state policy for higher education.

One cannot make such projections without relying heavily on the findings of previous studies and taking into account subsequent developments. Few other subjects of public concern have received greater attention than higher education. Several studies in recent years have concentrated on one phase or another of this subject in Illinois. Two in particular have taken a broad look at the problems in this field. Other studies with a national view have something of relevance to the situation in Illinois.

A special bibliography is listed at the end of this chapter for the convenience of readers who would like to get better acquainted with the investigations on higher education in Illinois. Some of the major ideas and concerns of these studies are particularly germane to the present analysis.

Three recent studies make some projections which have a direct bearing on the problem of estimating needs in higher education. The first is the report of the Higher Education Commission in 1957, *Illinois Looks to the Future in Higher Education.* This Commission presented recommendations concerning the general needs for adequate education. Probable enrollments were projected to 1977. Economic trends were projected. Attention was given to the Chicago Undergraduate Division of the University of Illinois, needs for facilities in Southwestern Illinois, junior colleges, and coordination of higher education.

The second is the report by McLure and others in 1960 entitled *Vocational and Technical Education in Illinois.* This study made projections on the needs of junior college level education in vocational and technical fields. The evidence of need for specialized occupational training at this level of higher education led to suggestions for a state system of comprehensive type junior colleges. The findings of this study went beyond the estimates of the Higher Education Commission. The projections of (1) organizational structure and (2) the potential enrollments in junior colleges were on a larger scale than the estimates of the Commission.

The third report was made in 1961 by the Illinois Joint Council on Higher Education, entitled *Public Higher Education in Illinois.* This study

*The author is Director, Bureau of Educational Research and Professor of Education, University of Illinois. Statistical services were rendered by Dale Kaiser, Ronald Simcox, and Carl Thornblad, Research Assistants.

projected enrollments in a number of areas of professional education. It did not present an over-all projection of enrollments as found in the Commission's report of 1957. The Council laid down thirteen guidelines for developing a plan of higher education to meet the anticipated demands by 1975.

Recent Trends in Enrollments in Higher Education

Enrollments for the entire state are the best indicators of educational need. They reflect the demands of society for trained persons. They also express the sum total of human aspirations, drives, and sacrifices of individuals. They are highly associated with all the functions—instruction, research and public service—included in higher education. For these reasons the trends on enrollments provide a basis for projections of expenditures.

Trends of the past ten years are important as a basis for projecting the next ten years. The first step in this analysis is to examine the enrollments over the past ten years in public and private institutions. A further breakdown is then made between junior colleges and senior institutions of higher learning.

The story of these trends is shown in tables one through eight. The first six deal only with Illinois and the remaining two show comparative data for Illinois, a sample of states, and the national totals.

The enrollments of all institutions are shown in Table 1 with a division between junior colleges and all other (senior) institutions. The total fall (opening) enrollments increased from 138,916 in 1950 to 216,577 in 1961. These figures include full-time and part-time resident students and others enrolled in extension courses. All enrollments are in degree-credit courses. These figures do not represent the total number of persons registered during the academic year and the summer school. They do not distinguish between institutions on a semester, a quarter, or a trimester plan.

These limitations would be serious if our concern were to compare the educational loads of institutions. The data in this form are satisfactory for projection on a total state basis. This is true when the underlying relationships of summer school to academic year enrollments, full-time to part-time enrollments, full-time to extension enrollments and undergraduate to graduate enrollments are known. These relationships for all public institutions have been fairly constant in Illinois in the past ten years.

Several important observations can be drawn from Tables 1, 2, and 3. There was a dip in enrollments in 1951 and 1952. In these years the college age population 18-21 years of age reached a low point. These students were predominantly the depression babies of the early 1930's. Expanding enrollments since 1952 were a result of increased population and a steady increase in the proportion of the 18-21 age group attending college. In 1950 the enrollments were 28.3 percent of this age group. In 1960 they had increased to 41.5 percent. The comparative figures for the nation as a whole were 25.5 and 37.1 respectively.

TABLE 1

Opening (Fall) Enrollments in Institutions of Higher Education, State of Illinois

Publicly and Privately Controlled

Year	All Institutions	Junior Colleges	All Other Public and Private Institutions	Percent of Enrollments in Junior Colleges
1950	138,916	12,792	126,124	9.2%
1951	126,872	11,533	115,339	9.1
1952	125,715	11,896	113,819	9.5
1953	128,039	13,701	114,338	10.7
1954	139,582	17,638	121,944	12.6
1955	150,421	19,627	130,794	13.0
1956	165,636	21,266	144,370	12.8
1957	166,240	20,827	145,413	12.5
1958	173,222	21,924	151,298	12.7
1959	182,721	24,242	158,479	13.3
1960	200,152	32,242	167,910	16.1
1961	216,577	40,016	176,561	18.5

SOURCE: U. S. Dept. of Health, Education, and Welfare, Office of Education. Opening (Fall) Enrollment in Higher Education, OE Circulars.
Tabulations for 1950-1960 were prepared by Dr. Peter Klassen, Professor of Sociology, and Dr. Robert E. Corley, University of Illinois, Chicago Branch.

The trend of greatest significance is the relative growth of the public institutions, as shown in Tables 2 and 3. The changes are shown graphically in Chart 1. In 1950 the private institutions had nearly twice as many enrollees as the public ones. By 1961 the latter exceeded the former. The private institutions had a static situation with minor fluctuations from 1950 to 1958. Their increases occurred in the last three years. These trends are accounted for by the policies of these institutions. They have not attempted to expand in response to the increased demand for higher education. Instead they have followed the general policy of accommodating a fairly stable size.

Another important trend to note is the relative position of junior colleges. Enrollments in these institutions have increased at a much faster rate than those in the senior institutions. Note further in Tables 2 and 3 that most of these students are in the public junior colleges.

It is important to go beyond the total figures and observe the breakdowns between full-time and part-time students. These breakdowns are shown in Tables 4, 5, and 6. The reader's attention is called to the slight difference in total figures in Table 4 as compared to those in the preceding tables. The data in Table 4 are enrollments at the end of the fall term in which the opening enrollments are reported.

The first big difference is between the public and the private institutions. The latter have a much higher proportion of enrollments in part-time and extension work than the former. Therefore, the gross enrollments do not reflect the true educational load on a comparable basis.

This condition also holds true in comparing the respective loads of the public junior colleges and the public senior institutions. In this case, however, it should be pointed out that variations in programs produce different requirements in resources even with comparable enrollments. But the facts are that the public junior colleges have had about 15 percent of all full-time enrollments and about 61 percent of the part-time and extension enrollments in all public institutions.

The significance of the distribution between full-time and part-time enrollments will have to be recognized later in the projections. For this reason further attention is given to this factor in Tables 5 and 6. In recent years the public junior colleges have had a greater increase in part-time enrollments than in the full-time ones. The reverse trend has occurred in the public senior institutions.

The composition of the enrollments in the public institutions is chang-

TABLE 2
Opening (Fall) Enrollments in Institutions of Higher Education, State of Illinois
Publicly Controlled

Year	All Institutions	Public Junior Colleges	All Other Public Institutions	Percent of Enrollment In Public Junior Colleges*
1950	45,410	11,692	33,718	25.7%
1951	41,136	10,750	30,386	26.1
1952	43,012	11,196	31,816	26.0
1953	49,854	12,925	36,929	25.9
1954	57,897	16,742	41,155	28.9
1955	64,578	18,566	46,012	28.7
1956	70,975	20,106	50,869	28.3
1957	72,296	19,674	52,622	27.2
1958	78,994	20,598	58,396	26.1
1959	85,187	22,837	62,350	26.8
1960	98,962	30,629	68,333	31.0
1961	112,158	38,077	74,081	33.9

SOURCE: U. S. Dept. of Health, Education, and Welfare, Office of Education, Opening (Fall) Enrollment in Higher Education. OE Circulars, (Tabulations for 1950-1960 were prepared by Dr. Peter Klassen, Professor of Sociology, and Dr. Robert E. Corley, University of Illinois, Chicago Branch.)

*The reader will note from the figures in Table 5 that much of the increase in junior college enrollment consists of part-time students.

ing. There is a gradual increase in the proportion of undergraduates attending on a part-time basis in the junior colleges but decrease in the proportion of part-time students in the senior institutions. Some further increase in the proportion of part-time undergraduate to total enrollments may be expected as the Chicago and Edwardsville centers of the University of Illinois and Southern Illinois University, respectively, are developed. An even greater impact on this trend may be felt if the state undertakes an expansion of junior colleges.

The public institutions are having a sharp increase in the proportion of graduate students. Instruction at the graduate level is more directly associated with research than at the undergraduate level. The training of workers at the graduate level and research go hand in hand. The private institutions have had a fairly stable composition in these categories of enrollments. There has been no evidence to suggest a change in the distribution of categories in these institutions.

The writer finds no basis on which to estimate the differential effects of increasing proportions of part-time undergraduate enrollments and of graduate enrollments to total enrollments. Up to a point the former have relatively low demands on housing and operating costs. The latter are far

TABLE 3

Opening (Fall) Enrollments in Institutions of Higher Education, State of Illinois

Privately Controlled

Year	All Private Institutions	Private Junior Colleges	All Other Private Institutions	Per Cent of Enrollments In Private Junior Colleges
1950	93,506	1,100	92,406	1.2%
1951	85,736	783	84,953	0.9
1952	82,703	700	82,003	0.8
1953	78,185	776	77,409	1.0
1954	81,685	896	80,789	1.1
1955	85,843	1,061	84,782	1.2
1956	94,661	1,160	93,501	1.2
1957	93,944	1,153	92,791	1.2
1958	94,228	1,326	92,902	1.4
1959	97,534	1,405	96,129	1.4
1960	101,190	1,613	99,577	1.6
1961	104,419	1,939	102,480	1.9

SOURCE: U. S. Dept. of Health, Education, and Welfare, Office of Education, Opening (Fall) Enrollment in Higher Education. OE Circulars, (Tabulations for 1950-1960 were prepared by Dr. Peter Klassen, Professor of Sociology, and Dr. Robert E. Corley, University of Illinois, Chicago Branch.)

more expensive, particularly as they are associated with research. Each of these two increases tends to offset the rate of increase in cost. Thus the writer believes that it is reasonable to assume the present over-all composition of enrollments as a basis for projecting expenditures.

Illinois Enrollments Compared to Other States

Before leaving this analysis of demand for higher education in Illinois as reflected in recent enrollments, it is worthwhile to observe some comparative data for a few other states and the nation as a whole, shown in Tables

CHART 1

Trends of Opening (Fall) Enrollments in Higher Education in Illinois

a—All Private Institutions

b—All Private Institutions Minus Private Junior Colleges

c—All Public Institutions

d—All Public Institutions Minus Public Junior Colleges

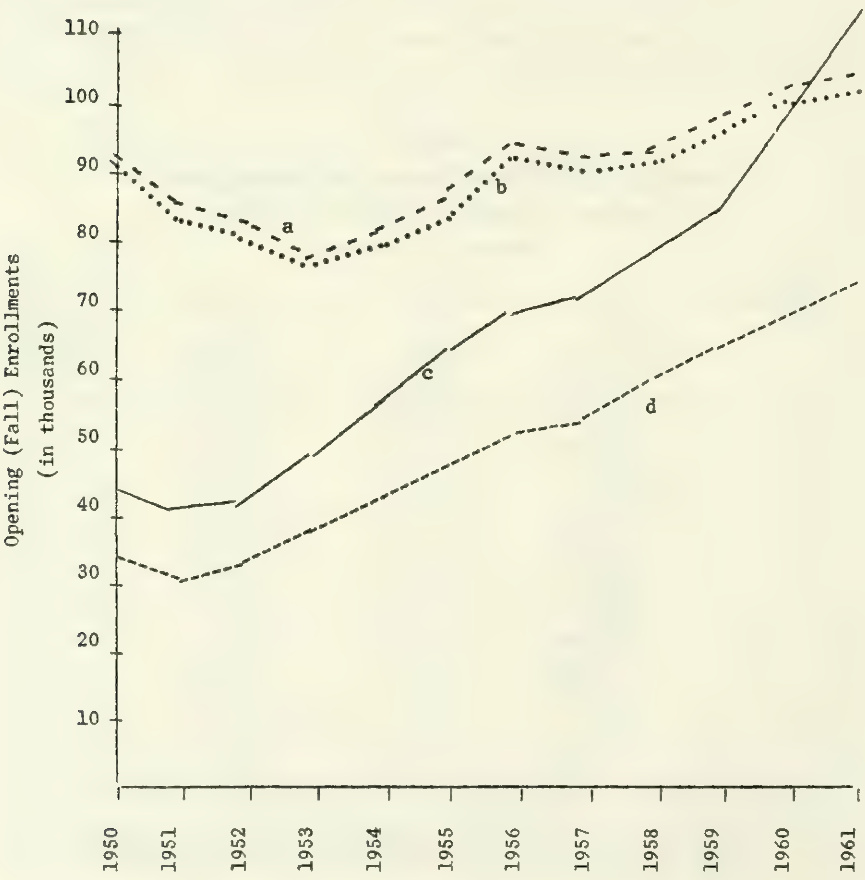


TABLE 4

Enrollments in Illinois Institutions of Higher Education
End of Fall Term

Year	Public: Full-Time Undergrad. and grad.	Public: Part-Time and Extension	Public: Percent of Total in Part-Time and Extension	Public: Total	Private: Full-Time Undergrad. and grad.	Private: Part-Time and Extension	Private: Percent of Total in Part-Time and Extension	Private: Total
1953	38,388	13,825	26.5%	52,213	53,068	26,678	33.5%	79,746
	(16)*	(61)*						
1954	45,598	13,970	23.5	59,568	56,465	27,977	33.1	84,442
	(16)	(63)						
1955	50,168	16,543	24.8	66,711	59,209	30,981	34.4	90,190
	(16)	(65)						
1957	51,767	17,059	24.8	68,826	63,279	31,618	33.3	94,897
	(12)	(56)						
1959	61,876	22,533	26.7	84,409	66,955	30,521	31.3	97,476
	(15)	(61)						

SOURCE: U. S. Dept. of Health, Education, and Welfare, Office of Education. Opening (Fall) Enrollment in Higher Education, OE Circulars, (Tabulations for 1950-1960 were prepared by Dr. Peter Klassen, Professor of Sociology, and Dr. Robert E. Corley, University of Illinois, Chicago Branch.)

*Figures in parentheses are percents of the respective enrollments in public junior colleges.

TABLE 5
Distribution of Full-Time and Part-Time Enrollees
Public Institutions

	Junior Colleges		Senior Institutions	
Year	Full-Time	Part-Time and Extension	Full-Time	Part-Time and Extension
1953	......47%	53%	83%	17%
1954	46	54	88	12
1955	42	58	88	12
1957	39	61	86	14
1959	40	60	86	14

SOURCE: Derived from Table 4.

TABLE 6
Trends in Composition of Enrollments in Higher Education
Percent of Total End-of-Semester Enrollment in Each Group

	PUBLIC				PRIVATE			
Year	Full-Time Under-Grad.	Part-Time Under-Grad.	Graduate	Extension	Full-Time Under-Grad.	Part-Time Under-Grad.	Graduate	Extension
1953	66.0%	17.9%	7.5%	8.6%	54.8%	32.6%	11.7%	0.9%
1954	66.8	16.2	9.8	7.2	54.6	32.2	12.2	0.9
1955	65.8	17.5	9.4	7.3	55.1	33.2	10.6	1.1
1957	65.0	18.9	10.2	5.8	55.1	31.9	11.6	1.4
1959	61.7	21.1	11.6	5.6	56.5	29.2	12.2	2.2

SOURCE: Derived from sources shown in Tables 1 and 2.

7 and 8. Illinois is compared with six midwestern states that have much in common. California is added because in many respects it is an acknowledged leader in higher education. Comparisons of enrollments between public and private institutions are shown in Tables 7 and 8. In every instance, the growth in public enrollments from 1949 to 1957 had become marked. On the other hand the private institutions did not recover their losses in the early 1950's until 1960 (see Table 3). An ever-widening gap between enrollments in public and private institutions in Illinois may be expected in the future. Despite this trend, however, enrollments in the private institutions may be expected to increase significantly. As noted in Table 7, this trend of a widening gap between public and private institutions has been established in a number of other states.

There is a considerable variation in the proportion of the total educational load which the public institutions in the respective states have carried. Among this group of states Illinois has had the lowest proportion of students

in the public institutions. From 1949 to 1957 Illinois ranked second to California in this group in the rate of growth of enrollments in the public institutions. By 1961 the public institutions in Illinois were enrolling 51.8 percent of the total students. From 1955 to 1961 enrollments in the public institutions increased 73 percent as compared to 22 percent in the private institutions.

Recent Trends in Expenditures and Revenues for Higher Education

The trends of revenue receipts and expenditures in recent years are helpful in projecting the financial needs of the next ten years. Expenditures show a definite relationship to total enrollments, although the two do not change at precisely the same rate. The relationship between the two in a given period of time foreshadows developments in the succeeding years.

Expenditures

Expenditures for current operation in the public institutions increased slightly less than the enrollments from the 1951-53 biennium to 1961-63. Expenditures advanced 171 percent while enrollments increased 187 percent. Put another way, the average annual rate of increase over the base year of 1951 was 17.1 percent for expenditures and 18.7 percent for enrollments.

TABLE 7
Comparative Enrollments in Higher Education in Illinois and Selected States
Opening (Fall) Enrollments*

State	Control	1949-50	1951-52	1953-54	1955-56	1957-58†
U.S. Total	Public	1,207,545	1,037,938	1,185,876	1,508,660	1,752,669
	Private	1,234,918	1,064,024	1,045,178	1,186,680	1,284,269
Illinois	Public	49,890	41,136	49,854	64,578	72,296
	Private	101,585	84,919	78,185	85,843	93,944
Indiana	Public	40,886	33,090	33,796	41,325	45,501
	Private	29,477	24,493	25,663	31,355	34,112
Iowa	Public	23,889	18,593	19,237	23,989	26,656
	Private	20,156	15,742	17,155	20,373	23,198
Michigan	Public	75,252	64,469	76,752	92,434	105,823
	Private	26,109	22,305	22,380	27,399	31,681
Minnesota	Public	32,157	23,641	25,609	32,224	47,738
	Private	18,552	16,025	16,289	18,137	19,958
Ohio	Public	72,422	58,917	60,835	72,163	81,097
	Private	65,321	57,305	52,333	59,427	66,809
Wisconsin	Public	30,947	25,458	28,455	36,497	40,491
	Private	18,731	15,772	16,828	19,530	21,702
California	Public	139,672	136,934	179,783	250,779	303,997
	Private	60,775	51,134	54,149	58,498	64,329

SOURCE: U. S. Department of Health, Education, and Welfare, Office of Education. Biennial Survey of Education Reports.
*All Degree-Credit enrollments—full-time, part-time, and extension.
†Circular No. 518, Opening enrollments in H. Ed. Inst., Fall, 1957. U. S. Office of Education.

TABLE 8

Proportion of Total Enrollments in All Institutions of Higher Education in Public Institutions*

State	1949-50	1951-52	1953-54	1955-56	1957-58
U.S. Total	49.4%	49.4%	53.2%	56.0%	57.7%
Illinois	32.9	32.6	38.9	42.9	43.5
Indiana	58.1	57.5	56.8	56.9	57.2
Iowa	54.2	54.2	52.9	54.1	53.5
Michigan	74.2	74.3	77.4	77.1	77.0
Minnesota	63.4	59.6	61.1	64.0	70.5
Ohio	52.6	50.7	53.8	54.8	54.8
Wisconsin	62.3	61.7	62.8	65.1	65.1
California	69.7	72.8	76.9	81.1	82.5

*Computed from data shown in Table 7.

The general magnitude of operating expenditures in public institutions is shown in Table 9. Data for junior colleges were not reported until 1959-60. The figures prior to that year are estimated from totals shown in alternate years in the Biennial Survey reports of the U.S. Office of Education. Expenditures of current operation are shown for two categories: (1) educational and general expenditures for operation of instruction, research, and

TABLE 9

Trends of Current Operating Expenditures for Higher Education in Illinois

Public Institutions
(in thousands of dollars)

	Educational and General			Grand Total Including Auxiliaries and Students Aid		
Biennium	Junior Colleges	All Institutions Except Junior Colleges	Total	Junior Colleges	All Institutions Except Junior Colleges	Total
1951-53	$ 9,057*	$109,762	$118,819*	$10,353*	$122,663	$133,016*
1953-55	10,450*	120,871	131,321*	12,649*	137,591	150,240*
1955-57	12,606*	148,123	160,729*	15,889*	167,973	183,862*
1957-59	14,425*	189,233	203,658*	17,803*	216,057	233,860*
1959-61	16,480	240,230	256,711	16,828	277,121	293,968
1961-63 (Estimated medium)	20,452*	300,000*	320,452*	21,000*	360,000*	381,000*

SOURCES: 1. Institutional Records.
2. *Statistics of Higher Education,* Chapter 4, Section II, U. S. Office of Education.
*Estimates.

TABLE 10

Capital Expenditures for Additions to Plants in All Publicly Supported Institutions Of Higher Education in Illinois

(in thousands of dollars)

Biennium	The Educational Plant*	Auxiliary Enterprises†	Total
1951-53	$21,337	$ 6,642	$27,979
1953-55	19,804	4,377	24,181
1955-57	24,206	8,363	32,569
1957-59	38,257	16.351	54,608
1959-61	18,465	33,288	51,753
1961-63	12,919‡	68.172§	81,091‡

SOURCE: Institutional records.
*These expenditures include state funds except very minor amounts of gifts and restricted funds.
†These expenditures include funds from self-liquidating sources.
‡Estimate of available funds excluding the Universities Bond Issue of $195 million.
§Borrowed funds.
NOTE: Estimates of funds from the bond issue to be spent in 1961-63 are not presented.

educational services and (2) expenditures for auxiliary services and student aid.

Capital expenditures are shown in Table 10. Facts are not available to indicate the lag of capital needs in relation to future enrollments. However, the state bond issue of $195 million which was passed in 1960 was an expression of state policy to reduce this lag as much as possible. Part of these funds will show up as expenditures in the 1961-63 biennium although the estimates in Table 10 do not include these funds.

Expenditures for auxiliary enterprises show a sharp upturn beginning in the 1957-59 biennium. These facilities include residence halls, food service, student activities buildings, and others. As enrollments increase, institutions find it necessary to expand these facilities.

Unit costs of operation are important in any analysis of trends. In this case available data do not afford the most accurate cost unit. There is no single unit of wide comparability among institutions with variations in programs and compositions of enrollments. There is an approximation, however, which is meaningful for this projection on a statewide basis where data on all institutions are combined. This is the average expenditure per fall enrollee, shown in Table 11. *This figure should not be confused with average cost per full-time student.* Most of the educational and general expenditure is for instruction but a substantial portion goes for research and public service. It is impossible, for example, to separate research completely from instruction, particularly at the graduate level. Even if research costs could be separated from instruction, the enrollments would still have to be

expressed in standard units such as full-time students. The reader must bear in mind throughout this report that the enrollments consist of a mixture ranging all the way from one student enrolled in one course to a full-time student enrolled in five or six courses.

TABLE 11

Trends of Current Operating Expenditures (Educational and General)

Public Institutions

	Average Expenditure Per Fall Enrollee Per Year		
Biennium	Junior Colleges	Senior Institutions	All Institutions Combined
1951-53	$412*	$1,765	$1,412
1953-55	352*	1,548	1,220
1955-57	326*	1,530	1,186
1957-59	358*	1,705	1,346
1959-61	308	1,838	1,394
1961-63	300*	1,860*	1,326*

*Estimated.

NOTE: The reader is cautioned again that these figures are *not* expenditures per student. They are average expenditures per gross or aggregate enrollee. We must keep in mind that the aggregate enrollment is a mixture of part-time and full-time students. But since the percent of part-time (including extension) enrollments to total enrollments have not fluctuated too widely (See Table 4) the recent trend of average expenditure per gross enrollee is important. There is a degree of stability in this trend to suggest the feasibility of using the average expenditure per gross enrollee in the biennium 1961-63 as a basis for projecting expenditures (Shown later in Table 19).

Data are not available to translate the aggregate enrollments into standard units such as full-time student equivalents or student credit hours. At best the writer can make only general estimates. In the biennium 1961-63 the total junior college enrollments are estimated to have about 55 percent of full-time student equivalents. This means that the figure of $300 per gross enrollee would be equal to about $545 per full-time student equivalent.

Comparable figures for the senior institutions on a standard cost unit basis are more difficult to estimate. In 1959 about 86 percent of enrollments in these institutions were students in full-time attendance. The full-time student equivalency would be close to 90 percent of the aggregate enrollment. Therefore, the figure of $1,860 per gross enrollment would be equal to approximately $2,000 per full-time student equivalent. But we must remember that this is an average for a wide range of students from the freshman year through the doctorate (sixth and seventh years). We know that upper undergraduates cost more than freshmen and sophomores, that first year graduates cost still more than the former, and that the per student costs in the doctoral programs are several times more than those for the undergraduates. The writer estimates that the average instructional cost

per full-time student equivalent for freshmen and sophomores in the biennium 1961-63 is between $900 and $1,100.

He estimated a defensible cost for junior college instruction in a recent study.[1] From an analysis of costs in a selected group of comprehensive junior colleges he estimated that a minimum defensible cost per full-time student in academic (college transfer) programs would be $800 per year by 1965. The minimum cost per full-time student in vocational and technical curricula was estimated at $1,000 by that year.

There appears to be a differential in cost between the senior and junior colleges for students in the thirteenth and fourteenth years. This would be true even after reorganizing and raising the financial level of the junior colleges to the minimum of $800 per full-time student equivalent. In other words, at this level of $800, which is about $250 above actual expenditures in 1961-63, the state could save from $100 to $300 in yearly operating costs for each full-time student who is accommodated in the junior college instead of a senior institution.

TABLE 12
Trends of Revenue Receipts for Public Institutions Of Higher Education in Illinois
Educational and General
(in thousands of dollars)

	Junior Colleges			Senior Institutions		
Biennium	State App.	Student Tuition and Fees	Other	State App.	Student Tuition and Fees	Other
1951-53	$	$	$	$ 82,001	$ 7,157	$23,625
				72.8%	6.3%	20.9%
1953-55	896			90,308	6,992	26,437
	20.5%*			72.9%	5.7%	21.4%
1955-57	3,082			109,885	9,167	33,658
	24.4%*			72.0%	6.0%	22.0%
1957-59	4,785			144,769	11,227	40,377
	33.2%*			73.7%	5.7%	20.6%
1959-61	6,982	862	10,077	181,951	13,253	53,810
	39.0%			73.1%	5.3%	21.6%
1961-63	—	—	—	221,848	14,505	63,890
(estimates)				73.9%	4.8%	21.3%

SOURCE: Institutional Records.
*Estimated.

Revenues

Trends of revenue receipts are of great importance as background information for projecting the financial needs of the future. Table 12 shows revenue receipts as indicated in institutional reports. These figures are ex-

[1] McLure and others, *Vocational and Technical Education in Illinois.* (See bibliographic reference).

pressed as dollar amounts in three categories: state appropriations, student fees, and other sources. Also the percentages which these categories are of the total educational and general income are shown. This distribution shows the difference between the sources of revenue in junior colleges and in the senior institutions. The former, operated by local school systems, receive over half of their revenue from "other" sources which are in this case local (property) taxes. The senior institutions have averaged 73 percent from state appropriations during the ten years from 1951 and 1961. Data on the junior colleges are not reported except for the last two years and hence a ten-year trend cannot be determined. Estimates have been made for state tax funds since 1953 when the first state aid grants were made available to the junior colleges.

Student fees in the senior institutions ranged from 6.3 percent of all educational and general income in the biennium 1951-53 to 4.8 percent in 1961-63. These are only the fees applicable to the cost of the instructional program. They do not include fees for student activities, health, laboratory charges, book rentals, and other auxiliaries. This decline in the percent of the total operating cost derived from student fees should not be misunderstood. In 1951-53 a considerable portion of the fees consisted of payments from the federal government for veteran's education in excess of the regular tuition rates. Furthermore the total operating budgets have been increased substantially from federal and other funds for research and experimentation. Hence, these two conditions have produced a decline in percents derived from student fees, but at the same time the actual amounts from this source were increasing.

The writer should like to emphasize that percentages of the total operating costs which are derived from student tuition and fees do not represent a valid basis for judging the fairness of amounts of these charges levied on the individuals. Institutions vary considerably within each state as well as among states in the proportion of operating cost (educational and general) which is devoted to research, experimentation and public service. Equivalent charges per individual under these conditions would still show variations in the percent of total income which is obtained from this source. The only fair basis for judging student tuition and fees is in terms of the relative financial burden placed on the individuals.

The funds labeled "other" are derived from federal grants, gifts, endowments, and miscellaneous sources. Recently the proportional amounts of these funds derived from the federal government for research and experimentation have increased markedly.

Comparative Revenues and Expenditures

To round out the recent trends of expenditures in higher education some comparisons of public and private institutions are presented. Table 13 shows trends in the distribution of income classified as tax revenue and non-tax revenue for public and private institutions in Illinois. These are the

TABLE 13

Recent Trends in Distribution of Income from Tax and Non-Tax Sources for Public and Private Institutions of Higher Education in Illinois

Educational and General Operating Expenses
(in thousands of dollars)

Year	Total Educ. and Gen. Revenue		Tax Revenue: Federal Government		Tax Revenue: State and Local Government		Non-Tax Revenue*	
	Public	Private	Public	Private	Public	Private	Public	Private
1951-52	$ 59,869	$100,419	$ 6,931	$45,224	$45,355	$ 4	$ 7,583	$55,191
			11.6%	45.0%	75.7%	—	12.7%	55.0%
1953-54	66,844	96,747	7,291	31,144	50,488	3	9,065	65,600
			10.9%	32.1%	75.5%	—	13.6%	67.9%
1955-56	81,908	116,260	8,866	36,779	60,765	37	12,267	79,444
			10.8%	31.6%	74.2%	—	15.0%	68.4%
1957-58	103,572	153,405	11,330	56,018	75,898	2	16,344	97,385
			10.9%	36.5%	73.3%	—	15.8%	63.5%

SOURCE: U. S. Department of Health, Education, and Welfare. Biennial Survey, Statistics of Higher Education, Office of Education Reports. Chapter 4, Section II.
*Non-tax revenue includes mainly such sources as student tuition and fees, gifts and grants, and endowment earnings.
NOTE: The operating costs of auxiliary services (food, dormitories, student activities, etc.) are financed entirely from non-tax revenue.

TABLE 14

Comparative Expenditures on Higher Education
Educational and General Expenditures
(in thousands of dollars)

State	Control	1949-50	1951-52	1953-54	1955-56	1957-58
U. S.	Public	$898,054	$1,052,826	$1,283,617	$1,575,314	$2,077,565
Total	Private	808,390	868,384	987,679	1,191,054	1,526,849
Illinois	Public	47,157	57,405	63,504	77,280	97,428
	Private	88,048	97,541	95,802	112,509	149,927
Indiana	Public	31,900	38,642	43,455	50,609	64,268
	Private	14,876	14,461	18,057	22,121	28,952
Iowa	Public	27,628	33,350	35,381	39,074	50,796
	Private	9,223	9,181	10,409	12,670	15,943
Michigan	Public	61,235	75,326	93,889	122,299	147,779
	Private	11,422	11,754	13,798	17,775	21,647
Minnesota	Public	30,505	34,536	41,419	45,908	58,867
	Private	8,179	8,186	10,172	11,885	15,357
Ohio	Public	37,968	45,354	52,914	61,635	79,776
	Private	29,691	31,066	36,743	43,810	55,340
Wisconsin	Public	27,902	33,264	38,647	42,279	53,433
	Private	9,704	9,765	10,081	14,152	18,210
California	Public	125,475	157,961	198,394	254,586	366,058
	Private	47,383	59,201	71,006	86,417	124,725

SOURCE: U. S. Department of Health, Education, and Welfare. Office of Education. Biennial Survey, Statistics of Higher Education. Chapter 4. Section II.

most recent data from the Biennial Survey of the U. S. Office of Education. Private institutions have received over three times as great a percent of their total educational and general income from the federal government as the public institutions received. The federal funds have been granted for research and experimentation and not for instructional programs. Furthermore, these revenues have been concentrated in only a few large institutions. The public institutions have received about three-fourths of their total revenue from state and local taxes. Local property taxes have constituted the major source of support for junior colleges. Private institutions have received from four to five times as high proportion of their total educational and general revenue from non-tax sources (gifts, endowments, fees, etc.) as the public institutions.

It is of interest to note that the federal grants to higher education in 1957-58 were fairly evenly distributed in total between public and private types of institutions throughout the nation. The former received 55 percent of federal funds and the latter received 45 percent of these funds. These percentages did not hold in Illinois where the public institutions received only 17 percent and the private institutions received 83 percent. Though these funds were farily evenly distributed between public and private types

of institutions in the nation it is obvious that the amounts were not related to enrollments. These comparisons have only one important value in this study, namely to give some indication of the trend in the major sources of revenue for the operating costs of educational programs in all institutions of higher education.

Other comparisons are shown between Illinois and a selected group of states, together with the national totals. Educational and general expenditures are shown in Table 14 for this sample over an eight year period. Public and private institutions are compared to illustrate the fact that expenditures in the public institutions are increasing faster than they are in private institutions. This is also true of enrollments as shown earlier in Table 7. The shift in the proportions of the load for higher education between these two types of institutions in Illinois will be phenomenal in the next ten years.

The allocation of resources for higher education can be examined further. First we can observe the proportion of the personal income of the state which these expenditures represent. These proportions are shown in Table 15 for selected states and the nation at large. Two figures are shown, the percent of personal income spent on public institutions and the total percent spent on public and private. The difference between the total and the public is the percent spent by the private institutions. These figures show a gradual increase in the percent of personal income which is devoted to higher education. The national total increased from 0.77 percent in 1952 to 1.02 percent in 1958. The total figures for Illinois were slightly above the national average. However, Illinois ranked below the national average on proportions of the personal income spent by public institutions.

These figures do not reveal the proportions of income spent by the respective types of institutions from taxes and non-tax sources. For example, in 1957-58, 36.5 percent of income of the private institutions in Illinois came from federal taxes. In the same year 10.9 percent of the income of public institutions came from this source and 73.3 percent came from state and local taxes. Thus, the total percent of the personal income in Illinois which was spent on all higher education in 1957-58 may be broken down as follows: 0.57 percent of income from taxes and 0.47 percent of income from non-taxes. This distribution, of course, assumes that all of the federal funds disbursed in Illinois were collected from this state. For the nation as a whole 0.54 percent of personal income was spent through tax sources and 0.48 percent was contributed directly through student fees, gifts, endowments and other non-tax means.

We should emphasize that these comparisons relate only to educational and general operating expenses. They do not include expenses for the educational plants or for the operating and capital costs of auxiliary services.

Projections, 1960-1970

The old cliche that hindsight is better than foresight assumes reality to anyone who seriously attempts to project the costs of an activity as com-

plex as higher education. There are seemingly too many variables to manage—increasing enrollments, expanding research and services, inflation of prices, shortage of adequately trained staff, lagging salary structures, economies through new methods and facilities, reorganization of the junior college system, and alternative expansions of programs in the state universities, to name a few.

But actually, no projection can take a large number of variables into account. At best only one or two basic indexes can be used and the others must be explained away by assumptions. In this case the writer is selecting enrollment as the fundamental index on which to base a range of estimated costs.

Projected Enrollments

The total enrollments in higher education for the state are estimated from 1960 to 1970 at three levels, high, medium, and low. These are shown in Table 16. The medium figures may be viewed as the most probable esti-

TABLE 15

Percent of Personal Income Spent on Higher Education For Educational and General Expenditures

State	Control	Year 1951-52	1953-54	1955-56	1957-58
U. S. Total	Public	0.42%	0.45%	0.51%	0.59%
	Total	0.77	0.80	0.90	1.02
Illinois	Public	0.33	0.32	0.37	0.41
	Total	0.89	0.81	0.90	1.04
Indiana	Public	0.57	0.54	0.62	0.70
	Total	0.78	0.77	0.89	1.01
Iowa	Public	0.84	0.86	0.93	0.99
	Total	1.07	1.11	1.23	1.30
Michigan	Public	0.64	0.65	0.79	0.87
	Total	0.74	0.74	0.90	1.00
Minnesota	Public	0.78	0.82	0.85	0.96
	Total	0.96	1.02	1.07	1.21
Ohio	Public	0.30	0.31	0.33	0.38
	Total	0.51	0.52	0.57	0.65
Wisconsin	Public	0.58	0.62	0.64	0.72
	Total	0.75	0.78	0.86	0.96
California	Public	0.71	0.74	0.87	1.04
	Total	0.98	1.01	1.16	1.39

SOURCE: U. S. Department of Health, Education, and Welfare. Office of Education. Biennial Survey of Educational Reports. Chapter 4. Section II.
NOTE: The difference between the figures shown for *total* and *public* is the percent of personal income represented by the expenditures of private institutions.

mates. However, in this analysis their importance lies merely in representing the mid-point of the probability range between the high and the low estimates.

These projections are extended to 1980 to illustrate that the pattern of acceleration will not stop in 1970. The children are now born who will be reaching college age by 1980. The basic college-age population, ages 18-21, in Illinois is estimated[2] to increase from 482,304 to 763,000 in 1970. This is an increase of 58.2 percent as compared to an estimated increase of 56.6 percent for the nation as a whole. If we make certain assumptions such as continued peace, the continued increase in rate of college-age youth attending college, and the continued demands for college trained manpower,

TABLE 16

Projected Fall Enrollments in All Public and Private Institutions of Higher Education in Illinois

Total Degree-Credit Students; Full-Time, Part-Time and Extension

Year	Actual	Low*	Medium	High*
1950	143,972			
1955	150,421			
1960	200,152			
1961	216,577			
1962		231,597	232,652	233,708
1963		242,943	245,109	247,276
1964		249,382	253,025	256,669
1965		265,282	271,010	276,738
1966		286,941	295,519	304,097
1967		309,002	321,213	333,425
1968		331,438	348,183	364,928
1969		334,834	355,920	377,007
1970		340,317	366,512	392,707
1975		398,956	449,205	499,455
1980		433,330	493,992	554,655

*These estimates were prepared by Dr. Peter Klassen, Professor of Sociology, and Dr. Robert E. Corley, University of Illinois, Chicago Branch. The medium figures (average of high and low) are introduced by the writer.
Notes on these projections are shown in Appendix A.

we obtain the results as shown in Table 16, and again graphically in Chart 2. Technical notes on these projections and their source are presented in the Appendix A.

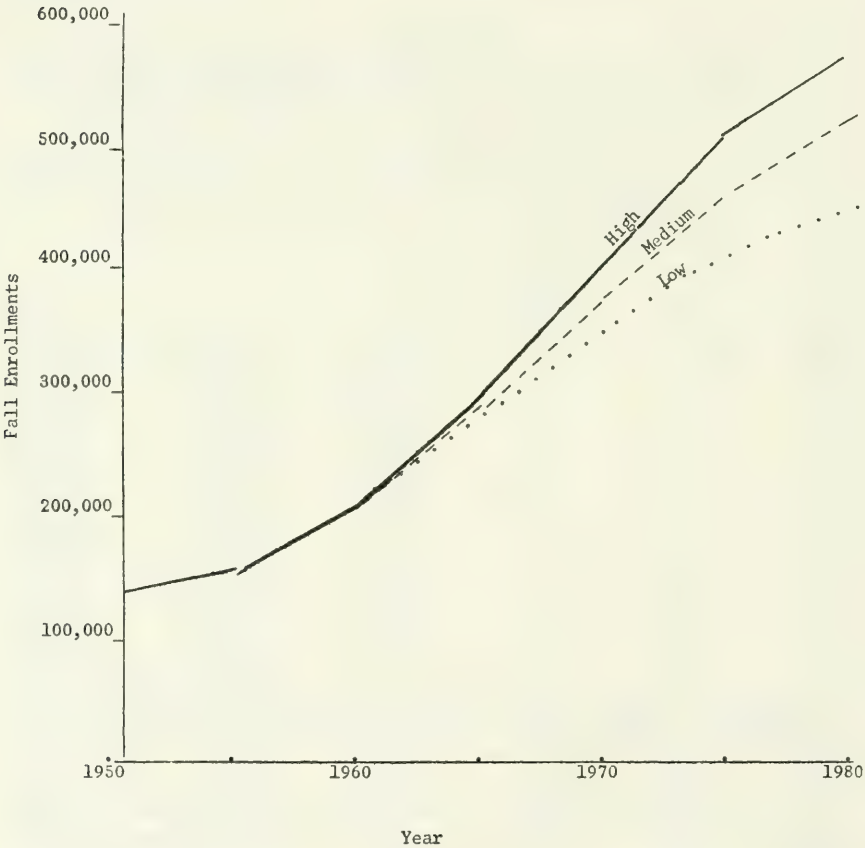
The next stage of projections is to estimate the distribution of enrollments between the private and the public institutions. The only basis on which the writer can estimate the probable enrollments in the private

[2] Research Division, National Education Association. *Population Projections 1960-1970.* Washington, D.C.; The NEA, June 1961.

institutions is the trend from 1950 to 1960. During that period enrollments in these institutions increased eight percent. An annual increase of one percent from 1960 to 1970 seems reasonable to expect.[3] Thus it is estimated that the total enrollments in the private institutions will increase from 101,190 in 1960 to 111,778 in 1970. While this anticipated change is not large compared with the public institutions, this growth would be a substantial increase.

CHART 2

Projected Enrollments in All Institutions of Higher Education in Illinois



The public institutions are expected to increase in enrollments from 98,962 in 1960 to a low of 228,539 in 1970. The medium estimate is 254,734 and the high is 280,929. The figures for each of the next ten years are shown in Table 17.

[3] Professor Peter Klassen, on whose projections of total enrollments the writer has depended, concurs in this judgment.

A further breakdown is shown in Table 18 between the public junior colleges and the public senior institutions. In this case the estimates are shown on a biennial rather than annual basis.

The junior college projections are based on an average annual increase of 15 percent from 1960 to 1970. This estimate is a reduction from 33.9 percent of the total public enrollments in 1961 to 30 percent of the medium totals in 1970. From 1950 to 1960 the growth in junior college enrollments averaged 16.3 percent per year.

The estimate for junior colleges may be high or low, depending on the policy of the state to undertake development of a comprehensive program of education in these institutions. The writer is assuming that by 1965, when the General Assembly will have proposals on this subject from the Board of Higher Education, steps will be taken for such development which will have an impact by 1970. In that case these estimates could be moderate or even low. Otherwise they may be slightly high.

TABLE 17
Projected Fall Enrollments in Higher Education By Types of Institutions

Year	Private Institutions*	Public Institutions		
		Low	Medium	High
1960 (actual)	101,190	98,962	98,962	98,962
1961 (actual)	104,419	112,158	112,158	112,158
1962	103,224	128,373	129,428	130,484
1963	104,256	138,687	140,853	143,020
1964	105,299	144,083	147,726	151,370
1965	106,352	158,930	164,658	170,386
1966	107,416	179,525	188,103	196,681
1967	108,490	200,512	212,723	224,935
1968	109,575	221,863	238,608	255,353
1969	110,671	224,163	245,249	266,336
1970	111,778	228,539	254,734	280,929

*Estimated at 1% annual increase.

Projected Expenditures

From the biennium 1951-53 to 1961-63 total educational and general expenditures in public institutions of higher education in Illinois increased an estimated 171 percent.[4] At the same time total enrollments increased 187 percent. The relationship of expenditures to enrollments during this period seems to be the best basis for estimating expenditures through the biennium 1969-71.

[4] The figures for the 1961-63 biennium include the actual expenditures for 1961-62 and estimates from institutional comptrollers for 1962-63.

TABLE 18

Projected Distribution of Fall Enrollments
Public Institutions of Higher Education in Illinois

Biennium	Low			Medium			High		
	Junior Colleges	Senior Colleges	Total	Junior Colleges	Senior Colleges	Total	Junior Colleges	Senior Colleges	Total
1959-61 (actual)	53,466	130,683	184,149						
1961-63	82,627	157,904	240,531	82,627	158,959	241,586	82,627	160,015	242,642
1963-65	98,672	184,098	282,770	98,672	189,907	288,579	98,672	195,718	294,390
1965-67	112,968	225,487	338,455	112,968	239,793	352,761	112,968	254,099	367,067
1967-69	129,335	293,040	422,375	129,335	321,996	451,331	129,335	350,953	480,288
1969-71	148,073	304,629	452,702	148,073	351,910	499,983	148,073	399,192	547,265

The estimates are based on the expenditure level per gross enrollee prevailing in the 1961-63 biennium. The average figures of $300 per enrollee in the junior colleges and $1,860 per enrollee in the senior institutions are applied to the low, medium, and high projected enrollments. The reader is reminded again that these figures must not be confused with amounts per full-time student. No estimate is made for possible change in the price structure of the economy which would affect educational costs.

The projections are shown on a biennial basis in Table 19. For the ten-year period from 1959-61 to 1969-71 the estimated increases compared to projected enrollments are as follows:

	Low	Medium	High
Enrollments	145%	171%	197%
Expenditures	138	172	207

These estimates are in line with a number of projections for the nation. Harris[5] estimated an increase in educational and general expenditures of $3.6 billion in 1957-58 to $9.2 billion in 1969-70, an increase of 170 percent. He estimated a capital budget of $1.5 billion per year. Babbidge[6] estimated national expenditures for higher education to reach $9 billion by 1970-71 and $12.5 billion by 1975-76. Rivlin,[7] writing in 1961, estimated an increase of "two and a half times as great as the present" for the next ten years.

The estimated state tax revenue for educational and general expenses is based on 73 percent of the total. This is the past ten-year average (rounded) for the state's contribution to these expenses in the senior institutions. The proportion of the junior college expenses received from state funds has been increasing and it is assumed that a figure comparable to the other institutions would not be unreasonable. These projections are shown in Table 20.

The writer has made no projections for operating and capital costs of auxiliary services. These have been almost totally self-supporting and the assumption is that this practice will continue.

It is necessary, however, to make estimates of capital expenditures for additions to the educational plants. These expenses are derived almost wholly from state tax revenues, with minor amounts from gifts and grants from miscellaneous sources. Capital funds for junior colleges have been obtained from local taxes in the past.

The capital estimates presented in this report are shown in Table 21. The estimates are broken down into two purposes. One is the estimate of payments to begin the amortization of the Universities Bond Issue of 1960. These estimates are based on current monthly payments of $856,208 by the

[5] McGraw-Hill Book Company, Inc. *Financing Higher Education 1960-1970.* New York: The Company, 1959, pp. 35-36.
[6] Babbidge, Homer. "Financing Higher Education," *College and University Journal,* Vol. 1, No. 1, Winter 1962, pp. 35-38.
[7] Rivlin, Alice M. *The Role of the Federal Government in Financing Higher Education,* Washington, D.C.: The Brookings Institution, 1961, p. 6.

State Treasurer to amortize $145 million of bonds sold to bear slightly under 3 percent interest. It is assumed that the remainder of $50 million will be sold to bear the same interest rate and that proportionate amortization payments will be scheduled.

The other purpose of capital estimates is for further expansion of plants in addition to amounts available from the Universities Bond Issue. These projections are based only on estimates of senior institutions. They do not include estimates for expansion of junior colleges. It is the writer's opinion that these estimates provide a reasonable range for projection of fiscal policies until a master plan is developed for expansion of junior colleges. At that time this high projection is likely to become a low estimate.

TABLE 19

Projection of Educational and General Expenditures

Public Institutions of Higher Education

(in thousands)

Biennium	Low	Medium	High
1959-61 (actual)	$256,711		
1961-63	318,490	$320,452	$322,416
1963-65	372,024	382,829	393,637
1965-67	453,296	479,905	506,515
1967-69	583,855	637,713	691,573
1969-71	611,032	698,975	786,919

Estimates computed as follows:
1. Junior Colleges — $300 per Enrollee.
2. Other Institutions — $1,860 per Enrollee.

TABLE 20

Projected State Tax Revenue for Educational and General Expenditures of Higher Education

(in thousands)

Biennium	Low	Medium	High
1961-63 (actual)	$221,848	$221,848	$221,848
1963-65	271,578	279,465	287,355
1965-67	330,906	350,331	369,756
1967-69	426,214	465,530	504,848
1969-71	446.053	510,252	574,451

NOTE: These estimates are based on 73 percent of Total Projected Educational and General Expenditures.

TABLE 21

Projected State Tax Revenue for Capital Expenditures of Higher Education
(in thousands)

Biennium	Payments on Universities Bond Issue 1	Low: Further Expansion of Plants 2	Low: Total (No. 2 Plus No. 1) 3	Medium: Further Expansion of Plants 4	Medium: Total (No. 4 Plus No. 1) 5	High: Further Expansion of Plants 6	High: Total (No. 6 Plus No. 1) 7
1963-65	$27,635	$49,740	$ 77,375	$59,460	$ 87,095	$ 73,110	$100,745
1965-67	27,635	70,840	98,475	77,860	105,495	84,710	112,345
1967-69	27,635	63,110	90,745	71,235	98,870	74,284	101,919
1969-71	27,635	81,410	109,045	91,760	119,395	106,410	134,045

In any event these projections for capital expenditures do not represent estimates of total needs. These figures are sufficient to enable the state to lay out long-range plans with confidence and to stay within a short reach of reasonable fulfillment of needs as they occur.

A summary of total projected state tax revenue for higher education is shown in Table 22. This is the range based on 1962 prices with no estimates for change in the price structure of the economy.

TABLE 22
Summary of Projected State Tax Revenue for Educational and General and Capital Expenditures of Higher Education
(in thousands)

Biennium	Low	Medium	High
1963-65	$349,953	$366,560	$388,100
1965-67	429,381	455,826	482,101
1967-69	516,959	564,400	606,767
1969-71	555,098	629,647	708,496

Summary

These estimates at the upper limits may be entirely too conservative. They are based on a flow of student population which moves something like this. About two-thirds of the potential youth graduate from high school. A little under half of the graduates enter college. Only a little over half of that number stay on to graduate. Thus about one youth out of five graduates from college.

The power of education in the life of this nation is now well established. We have known this for a long time but our public policies have not reflected fully our inner convictions. The contributions of education to economic growth and to all aspects of the cultural fiber are clearer than ever.

We have not been sure, however, of the extent to which society can afford to educate everybody at public expense. Since higher education is the finishing stage of the individual's preparation for work, our traditional view of this phase has been associated largely with direct benefits to the individual. We have been relatively unaware of the larger value of the ubiquitous indirect benefits to society. Thus we have tended to expect the individual to pay the major portion of cost of this education.

But in time there has been a gradual shift from almost complete allocation of financial resources through private means of philanthropy and individual contributions of fees, living expenses, and foregone earnings. These sources have been supplemented gradually by tax sources until today

some public institutions are erroneously referred to as public free institutions. Even in those cases where the major portion of the operating costs of the institution is obtained from public taxes, the public contributions are still less than a third of the total costs when the out-of-pocket costs and the foregone earnings of students are considered.

Our society relies on information, guidance, open persuasion, and individual choice to maintain a balance between individual and social demands for higher education. The individual demands are shaped in part by the intellectual capacity of the person. They are also shaped by the extent to which the individual can manage his opportunity costs. These latter limitations are a great cause of drop-outs all the way up through the educational system.

The total cost of education is an investment from individual and public sources. Public policy will always be confronted with the maintenance of a delicate balance between these two components. Currently it is clear that the public demands of trained manpower in the national interest are not being met because large numbers of individuals with ample intellectual capacity are not able to manage the economic requirements facing them. It would seem, therefore, that an increase in the relative contribution from the public tax sources might be in the national interest.

A recent study[8] at the University of Illinois pointed up the seriousness of the economic problem which many students face. It helps to explain a major reason why so many youth drop out of school and why an undetermined number never enter. In this study a representative sample of students at the University kept detailed, daily records of their expenditures and sources of funds during the second semester of the 1959-60 academic year. The average expenditures during that semester were $821 for the single resident students and $1,663 for the married resident ones. The corresponding figures for all students (resident and non-resident) were $872 and $1,734 respectively. The lowest 25 percent of all (resident and non-resident) single students spent $606 and the highest 25 percent $1,237 during one semester. Tuition and fees ranged from 16 to 18 percent of expenditures. The lowest 25 percent of married male students (resident and non-resident) spent $1,150 and the highest 25 percent spent $2,444 during one semester. Their tuition and fees ranged from 8 to 11 percent of expenditures. These expenditures should be doubled to cover the academic year of nine months.[9]

Sources of funds reveal the critical nature of the student's economic problem. The mean income of the single students was as follows: 20 percent current earnings, 14 percent scholarships and awards, 36 percent relatives, 18 percent assets (mostly summer earnings), 2 percent loans and 10 percent

[8] The University Committee on Student Economics. *Student Economics at the University of Illinois*. Urbana, Illinois: The Committee. 1961.

[9] Recent catalogues of institutions in other states indicate either minimum or average costs for an academic year as follows: Ohio State University, $1,240; Michigan State University, $1,218; University of Wisconsin, $1,400; University of Minnesota, $1,300. For comparative figures on tuition and student costs see Tables 24 and 25 in Appendix B.

miscellaneous. The mean income of the male married students was distributed as follows: 27 percent current earnings, 25 percent wife's current earnings, 26 percent scholarships and awards, 9 percent relatives, 3 percent loans, and 10 percent miscellaneous. Over half of the members of the sample indicated that the income received from relatives came from current family income. It appears from this study, and many others which corroborate these general findings, that over half of the students in higher education have an economic struggle to stay in school.

The average costs of higher education to the student in public and private institutions have come close together in recent years, that is when differences in tuition and fees are eliminated. A comparison of these costs for institutions in Illinois is shown in Table 25 of Appendix B.

It is understandable, therefore, why educational leaders in the public institutions advocate policies which provide low tuition and fees, scholarships, low cost food and housing, and other means of aid. The economic status of most students also explains why they are not ready for year-round attendance. To many of them the savings from summer employment provide the slim margin of assurance for meeting the next year's school bills.

This economic situation of large numbers of students is also an important reason why educational leaders advocate development of comprehensive junior colleges within commuting distance of the homes of many students. Many who are now in senior institutions could manage their economic problems better by living at home two years. Additional ones who now cannot attend school would be able to do so under those conditions. Furthermore, if appropriate two-year programs were available in a wide variety of technical fields, many students would become successful technicians who today are dropping out of engineering and other professional programs.

The writer has been unable to make any estimates of the probable effects of hypothetical increases in student tuition. The evidence just cited in the study of student economics at the University of Illinois strongly suggests that a larger proportion of students than generally realized have a difficult problem financing their costs of education. Many capable individuals fail to apply for admission for lack of financial resources.

It would seem, therefore, that the most rational solution is to reduce rather than to raise fees, except in a few cases where raises might be justified to put the state-supported institutions on a comparable basis. This conclusion is based on the evidence that the total contribution of the individual has reached a level which excludes a large number of persons who should obtain college training. Many students are known to drop out of college for economic reasons.

There are others who hold a contrary view about student tuition and fees. They believe that individuals should pay a larger share of the total cost since students are the primary beneficiaries. This view seems to be

represented by Mr. Richard K. Vedder in his chapter on Fees, Charges, and Other Non-Tax Sources of Revenue.

The writer would like to call to the attention of the reader, however, that the benefit theory has two sides, the direct and the indirect. While the students benefit directly, society benefits indirectly. The best available evidence indicates that the indirect economic benefits to society from college trained persons are twice as great as the direct gain to the students. Therefore, to err on the side of raising fees could result in short-sighted public policy.

Appendix A

Notes on Projection of Enrollments

The writer is indebted to Professor Peter P. Klassen and his assistant Dr. Robert E. Corley, University of Illinois Chicago Undergraduate Division, for the data on enrollments. These gentlemen have compiled the trend data from 1950 to 1960 from the Biennial Survey reports of the United States Office of Education. In addition they have completed the difficult task of projecting college-age population and enrollment.

Some of the data have been published in *Indicators and Trends, Higher Education State of Illinois, 1950-1980, University of Illinois, 1961.*

The assumptions and procedures used in that report are reproduced herein with the permission of Dr. Klassen and Dr. Corley to explain the basis for the projections used in this report.

Assumptions

The college-age population projections and enrollment predictions presented in the following pages were made on the basis of the following assumptions:

1. Mortality rates will remain at their current (1960) levels.
2. The 1958-60 fertility levels will remain constant in the next few years.
3. The rate of in-migration of children and youth 0-21 years of age throughout the period of this forecast will be the same as the rate which prevailed between 1950 and 1960.
4. The rate of out-migration of college youth in general will follow the observed patterns of 1949 and 1958.[10]
5. Commercial, industrial, and residential expansion in the state of Illinois will follow that of the 1950's and in general will parallel that of the United States as a whole.
6. There will be continued improvement in the holding power of students in Illinois higher education institutions on both the under-

[10] Robert S. Storey, *Residence and Migration of College Students*, U. S. Office of Education Miscellaneous Circular No. 14 (Washington: U. S. Printing Office, 1951). American Association of Collegiate Registrars and Admissions Officers, *Home State and Migration of American College Students*, Fall, 1958, (AACRAO, Ohio University, Athens, Ohio 1959).

graduate and graduate levels.

7. Privately supported and state publicly supported institutions of higher education in the aggregate will continue to expand their institutional facilities commensurate with the general increase in the size of the college-age population.

8. Finally, no major calamity, such as a war or other national disaster, will occur within the period of this forecast, and general socio-economic conditions will continue to follow the anticipated upward trend—in short, no major recession or depression is anticipated for the period of this forecast.

TABLE 23

Actual and Projected Fall Term Total Enrollment Rates For 1950 to 1970: Illinois and United States

Year (Fall Term)	Actual		Historical Trend*		Projected Trend		
	Ill.	U.S.	Ill.	U.S.†	Series "A*"	Series "B*"	U.S.
1950	28.3	25.5	26.8	23.4			
1951	27.1	24.0	28.2	24.8			
1952	28.3	24.9	29.7	26.3			
1953	29.7	26.3	31.2	27.7			
1954	33.1	28.8	32.7	29.2			
1955	35.4	30.9	34.2	30.6			
1956	37.6	33.2	35.6	32.0			
1957	37.2	34.0	37.1	33.5			
1958	38.2	35.6	38.6	34.9			
1959	39.4	36.2	40.1	36.4			
1960	41.5	37.1	41.6	37.8			
1961					43.0	43.0	39.3
1962					44.2	44.5	40.7
1963					45.2	46.0	42.1
1964					46.1	47.5	43.6
1965					46.8	49.0	45.0
1966					47.4	50.4	46.5
1967					47.9	51.9	47.9
1968					48.2	53.4	49.3
1969					48.3	54.9	50.8
1970					48.3	56.3	52.2

SOURCE: Klassen, Peter P. and Corley, Robert E. *Indicators and Trends Higher Education State of Illinois.* University of Illinois, September 1961.

*State of Illinois and United States historical trend values in the enrollment rate were determined by the "least-squares method." The resulting equation represents a convenient form of extrapolation into the future.

†United States enrollment rates in this table are given for comparative purposes only.

In addition to these assumptions, enrollment rates (percents which the enrollments are of the population 18-21 years of age) are projected in two series, high and low. The reader should bear in mind that all enrollees do not fall within this age group. Since most of them are within these limits, this population group is a useful base for predictive purposes. These projections are shown in Table 23.

Appendix B

TABLE 24
Student Tuition and Required Fees in A Sample of Universities

	Acadmic Year	
	Resident Undergraduate	Non-Resident Undergraduate
University of California, Berkeley (1962-63)	$150	$650
Indiana University (1961-62)	210	540
University of Iowa (1962-63)	290	620
University of Illinois (1962-63)	270	620
Michigan State University (1962-63)	324	870
University of Michigan (1961-62)	280	750
University of Minnesota (1961-62)	273	600
Ohio State University (1962-63)	330	780
University of Wisconsin (1962-63)	236	725

SOURCE: Undergratuate Catalogue of each institution.

TABLE 25
Student Costs in Illinois Colleges and Universities, 1960-61

	Tuition and Fees For Illinois Residents	Room and Board in College Dormitories	Total
University of Illinois	$ 200.00	$ 820.00	$1,020.00
Northern Illinois University	216.00	690.00	906.00
Eastern Illinois University	192.00	648.00	840.00
Illinois State Normal University	180.00	700.00	880.00
Western Illinois University	162.00	630.00	792.00
Southern Illinois University	184.50	666.00	850.50
Augustana	730.00	600.00	1,330.00
Aurora	605.00	578.00	1,183.00
Blackburn	472.00	300.00	772.00
Bradley	690.00	770.00	1,460.00

Table 25 continues on page 240

TABLE 25 (Continued)

Student Costs in Illinois Colleges and Universities, 1960-61

	Tuition and Fees For Illinois Residents	Room and Board in College Dormitories	Total
Carthage	700.00	320.00	1,020.00
Concordia Teachers College	255.00	510.00	765.00
Elmhurst	645.00	550.00	1,195.00
Eureka	498.00	535.00	1,033.00
Greenville	510.00	495.00	1,005.00
Illinois College	600.00	650.00	1,250.00
Illinois Wesleyan	700.00	700.00	1,400.00
Kendall	570.00	700.00	1,270.00
Knox	1,275.00	825.00	2,100.00
Lake Forest	850.00	800.00	1,650.00
Lewis College	540.00	650.00	1,190.00
Lincoln	850.00	650.00	1,500.00
Loyola	790.00	760.00	1,550.00
McKendree	500.00	500.00	1,000.00
MacMurray	780.00	870.00	1,650.00
Millikin	670.00	700.00	1,370.00
Monmouth	980.00	715.00	1,695.00
Monticello	885.00	1,000.00	1,885.00
Mundelein	500.00	600.00	1,100.00
National College	850.00	680.00	1,530.00
North Central	680.00	615.00	1,295.00
North Park	584.00	610.00	1,194.00
Northwestern	1,005.00	731.00	1,736.00
Olivet Nazarene	510.00	590.00	1,100.00
Principia	1,283.00	1,012.50	2,295.50
Quincy	600.00	700.00	1,300.00
Rockford	800.00	700.00	1,500.00
Rosary	610.00	800.00	1,410.00
St. Bede	320.00	750.00	1,070.00
St. Francis	330.00	630.00	960.00
St. Procopius	520.00	580.00	1,100.00
Shimer	750.00	945.00	1,695.00
University of Chicago	1,100.00	900.00	2,000.00
Wheaton	660.00	700.00	1,360.00
St. Xavier	550.00	800.00	1,350.00

SOURCE: Steiner, Gilbert Y., Study Director. *Public Higher Education in Illinois.* Springfield Illinois: Illinois Joint Council on Higher Education, 1961. pp. 164-165. (Used with permission of the Study Director).

Selected Bibliography

1. Babbidge, Homer, "Financing Higher Education," *College and University Journal,* Vol. 1, No. 1, Winter 1962, pp. 35-38.
2. Commission in Relation to the Establishment of a Branch of the University of Illinois in the Chicago Area. *Report to the Sixty-ninth Session of the General Assembly of the State of Illinois,* February 24, 1955. (Miemographed).
3. Griffith, Coleman R. and Blackstone, H. *The Junior College in Illinois.* Urbana: University of Illinois Press, 1945.
4. Henry, David D. "The Financing of Public Higher Education in the Next Ten Years." Address delivered at Missouri Assembly on Higher Education, Columbia, Missouri, April 8-10, 1962. (Mimeographed).
5. Higher Education Commission. *Illinois Looks to the Future in Higher Education.* Springfield: State of Illinois, 1957. 219 p.
6. Ivey, John E. Jr. *A Preliminary Report on the Educational Needs of the East St. Louis Area.* Springfield: Legislative Council, State House, February 1957.
7. McGraw-Hill Book Company, Inc. *Financing Higher Education 1960-70.* New York: The Company, 1959. 304 p.
8. McLure, William P. and others, *Vocational and Technical Education in Illinois.* Urbana: University of Illinois, Bureau of Educational Research, 1960. 163 p.
9. Mushkin, Selma J., Editor. *Economics of Higher Education,* Washington, D.C.: U.S. Department of Health, Education, and Welfare. Office of Education, 1962. 406 p.
10. Office of Education, U.S. Federal Security Agency, *Report of the Study of the Structure of the State Tax-Supported System of Higher Education in Illinois.* Washington, D.C.: U.S. Government Printing Office, 1950.
11. Rivlin, Alice M., *The Role of the Federal Government in Financing Higher Education,* Washington, D.C.: The Brookings Institution, 1961.
12. Steiner, Gilbert Y. Study Director. Staff Report. *Public Higher Education in Illinois.* Springfield: Illinois Joint Council on Higher Education, 1961, 198 p.
13. University Committee on Student Economics, *Student Economics at the University of Illinois.* Urbana, Illinois: The Committee. February 21, 1961. 39 p.
14. Willis, Benjamin C., "Report on the Chicago City Junior College to the Chicago Board of Education," May 23, 1956. Planographed.
15. ————, "Report on the Chicago Teachers College to the Chicago Board of Education," June 13, 1956. Planographed.
16. Works, George A., Director. *Report of the Commission to Survey Higher Educational Facilities in Illinois,* Springfield: The Commission, 1945.

CHAPTER V

VOCATIONAL EDUCATION

By Ralph O. Gallington*

The Project

Introduction—The main purposes of this study were to investigate and summarize past programs of vocational education in Illinois and elsewhere; to note trends, evolving needs, and likely programs which might meet evolving needs; and to estimate, on a scale of varying degrees, the cost figures for providing vocational education. The varying degrees were to be estimated in terms of (1) low, (2) medium, and (3) high costs.

Some of the past costs, enrollments, and facilities have been studied; certain trends have been established; and costs of programs have been projected through 1970. Vocational patterns and trends have been considered in making projections, and it is recognized that certain limitations will have an effect on these projections. A shift in vocational patterns cannot be predicted accurately. The value of the dollar can change and make cost estimates obsolete. Based on the data collected, it is probable, however, that satisfactory long-term planning may be accomplished and that a more realistic program of vocational education may be developed.

Organization—In this report the generalizations are introduced early in the presentation.[1] The more detailed report which follows documents the generalizations with appropriate statistical data. By this organization the reader's time is given prime consideration. One may quickly scan the important substance of this report by reading the first few pages wherein these conclusions and recommendations are presented. These generalizations refer often to source data which are presented in the statistical section.

Following the conclusions and recommendations are introductory statements describing the nature of the study. Next, in order of presentation, are: the background or introduction, the unemployment problem, the drop out and retention problem, some of the effects of vocational education, and the still unmet needs. The presentation of projections (tables of costs) follow.

Special terms have been used in the past to describe the various programs of vocational education. *Cooperative Part-time* vocational education is associated with the regular day-school program and includes vocational education such as Distributive Education and the Diversified Occupations offerings. *Day-School* vocational education includes vocational, vocationally-related, as well as the general education for vocational education students. It is handled in vocational schools, trade schools, comprehensive high schools and the like. Here *Out-of-School* vocational education refers to something

---

*The author is Professor of Industrial Education at Southern Illinois University. Statistical services were rendered by Mr. Robert Armbrust, Graduate Assistant at Southern Illinois University.

[1] Frederick L. Whitney, *The Elements of Research*. (New York: Prentice Hall, 1950), p. 405.

other than the day-school programs. It may be part-time or full-time training and is completely occupationally orientated. It has something to offer in general education but it is concerned with related occupation information, both technical and general. *General Continuation* industrial education would be classified under the latter in this report. This is because that program is largely a full-time work program and its costs are considerably lower per pupil than the day-school program.

Generalizations

1. About one-third of students in grades 9 through 12 in Illinois drop out of school either at the end of the 12th grade or before (see Table 1). There is no significant trend toward an increase in the retention rate.

2. On the national level about 42 percent of all those in the fifth grade drop out before high school graduation. There is a significant trend toward an increase in the retention rate here (see Table 2).

3. On the national level, less than one-third of the students in the fifth grade in 1950-51 entered college in 1958. The trends show, however, that a larger percentage of students may be expected to continue into higher education (see Table 2).

4. Vocational education probably has retention values for students who might otherwise drop out (see Charts 1 and 2).

5. Most of those who do not continue in higher education (about two-thirds of all the children) and perhaps more should develop in the public school some salable skills—vocational preparedness (see Table 2).

6. Of all high school youth in Illinois, about 14 percent are being provided vocational skills (see Chart 3 and Tables 3 and 4). This is considerably below the national average, 17.2 percent.

7. In Illinois, vocational education is provided to less than one-fourth of all those who should profit by it (see Tables 3 and 4 and Charts 3, 4, 5, and 6).

8. Students of the public school should be retained as long as they derive benefits from the educational program. When these youngsters drop out early, many of them seek and retain part-time "blind alley" jobs (see Table 4-A).

The vocational education programs, especially the cooperative part-time types, are placing many students on the jobs for which they have been trained (see Table 5 and Charts 7 and 8).

9. Illinois vocational educational programs should be made more flexible. It should be possible for more children to receive vocational preparedness before age 16. The temptation to enter some kind of employment at this age may deter many from entering a two-year program of vocational education (see the drop out record of children at the 9th and through the 12th grade level, Tables 1 and 2).

10. Consolidation of educational administrative units for vocational education would allow larger classes, fewer and better teachers for the numbers served, and better equipment with less depreciation costs per student.

11. There should be *consolidation* of population groups into area school districts, each offering one or more selected families of occupations, such as (1) agricultural education, (2) distributive and business education, (3) homemaking, (4) electrical trades and electronics, (5) machining of metals, hot metal working, foundry, heat treating, sheet metal fabrication, and the like, (6) wood and kindred industrial drafting and design. This again would allow for the organization of *larger classes* which could be taught by fewer and better teachers.

12. The rough average yearly costs per student (1959-61) in programs of vocational education in Illinois ranged from $17.55 to $29.05. The part-time cooperative programs cost considerably less than others. For example, the Distributive Education program was offered at a cost of approximately $17.55 per student. It appears that some areas of vocational education should be expanded, but in particular the part-time cooperatives seem to serve a wider variety of student interests and to put more students in line for a greater number of employment possibilities than any of the other areas (see Tables 4 and 4-A).

13. The Distributive Education and Diversified Occupations programs both have considerable possibilities in small communities where small numbers of students are involved.

14. Vocational education, training and retraining, presents one of the greatest needs of our society. It should be provided for adults and out-of-school youth. It should be organized to make better use of our surplus labor, the unemployed. Instead of persons being out of work for long periods, the period should be reduced to a very few weeks or months (see Table 8).

15. The cost of vocational training or retraining of adults for specific occupations has been between $115.96 and $432.50 per trainee. The average has been $271.41 per trainee (see Table 8). This is based on rather limited experience with this type of training, but it does illustrate the value of such training. The return of the money invested in training may be expected (by returns in taxes) within a reasonable time. In addition, upon completion of the training, full employment may remove many trainees from the public aid rolls (see Table 8).

16. The money saved in one year by employment to get one average unemployed person off the public aid or compensation rolls should provide vocational training or retraining for several others.

17. In Illinois the "high" cost for all vocational education in 1970 should be between 5 and 6 times as great as it is today; the "average" and "low" 4-5 and 2-3 times as great, respectively (see Tables 14, 15, 16, 17, and 18). These estimates are based on high and low costs among the seven

most populous states in the United States, including Illinois, and the estimated increase of 29.7 percent in the public enrollments (see Chart 9). Further, it is estimated that the need for vocational education demands an increase of from 14 percent to between 30 percent and 40 percent, for the vocational offerings in the state (see Chart 3).

18. During the period 1949-51 through 1959-61 in Illinois the *Common School Fund* increased over 200 percent. At the same time the state appropriations for *Vocational Education* increased slightly under 50 percent.[2] There seems to be no justification for this wide margin.

Background

In its broadest coverage the term *vocational education* refers to all types of education which prepares for specific occupations. This broad general interpretation of the term would include professional education, at all levels, which terminates in degree granting institutions, e.g., schools of law and medicine. For the purpose of this report, however, the term will apply only to specific occupational orientated education offered to train or retrain persons in school or out of school, for vocations requiring less than baccalaureate degrees. To suggest some of the families of occupations involved, a few illustrations follow: (1) farmers and farm workers, (2) business and kindred workers, including office workers, managers, proprietors, clerks, and sales people, and (3) craftsmen, operatives, and service men, including foremen, technicians, and kindred workers, skilled and semiskilled. Common labor is not among these classes of workers, because the "families of occupations" mentioned require vocational education, either prior to or immediately following employment. It has been assumed that common labor requires a very short learning or training period, and this at best is provided on the job.

In the past, much of the formal vocational education of youth occurred at the high school level or through apprenticeships. Within recent years, technological changes have frequently obviated certain employment classifications. When this occurs, retraining is necessary for the unemployed persons. Whereas some of this retraining has been offered to adults in high school classrooms, laboratories and shops, many times special training facilities have been set up.

The junior college level (13th and 14th grades) may become eventually the stratum where considerable terminal vocational education may be offered. This has considerable justification since more and more high school graduates are going on for more advanced and/or specialized training at the junior college level. Some short-term vocational and "technical" programs at this level are known as "certificate" programs; others culminate in an "associate" (two-year) degree.[3]

---

[2] State of Illinois, *Illinois School Problems* Commission No. 6, March, 1961.
[3] State of Illinois, Office of the Superintendent of Public Instruction, *Vocational and Technical Education in Illinois—Tomorrow's Challenge*. Bureau of Educational Research, College of Education, University of Illinois, Urbana, 1960, pp. 47-76.

Problems and Needs Data

Unemployment and the Drop Out Problem—One of the greatest problems in our society is the unemployment of heads of families. Each year many untimely school drop outs occur among children of under-employed parents. High school age students, especially, become obligated to help pay their own way and/or to share in the breadwinning for their families. Drop outs with little or no vocational training are forced to accept various menial tasks wherein the prospects for advancement are negligible. Families having such under-employment or unemployment are in need of vocational education. The head of the family is in need of vocational retraining and his children are in need of prevocational or vocational education. The ultimate cost of supporting this family on the public aid rolls far exceeds the cost of temporary vocational education and placement. Although he may need to have a considerable amount of money spent on him while in training, the unemployed worker will soon be self-supporting and repaying the amount spent for his training. The taxes assessed him and repaid to the State and nation will soon get him "out of debt" as far as society is concerned. If drop outs are to be cut, more heads of families must be kept employed.

Public school students should be retained as long as they are benefiting from the education afforded them. In many instances students drop out to earn money, but a greater number feel that they are failures in their climb up the academic ladder. In most cases drop outs feel that the school curriculum does not meet their needs. They report that they are interested "in the practical" and that "They wanted vocational instruction and work experience programs."[4]

"I was failing anyway," "I just wasn't interested in school," "I didn't like school," or "I was slower at catching on . . ." comprised 70 percent of reasons given by school-leavers for dropping out, according to Dillon.[5] Too frequently the school officials operate as if all elementary education is preparation for high school and all high school education is preparation for college. The fact is that a very small percentage (about 30 percent) enter colleges and a considerably smaller number complete a college degree. A very large number of students (over 30 percent) never complete high school (see Tables 1 and 4). Very few of these students have had any occupational education or vocational preparedness. Some recognition should be given to the characteristics of potential school drop outs. Potential school drop outs should be identified as early as possible; the typical drop out levels should be studied; adequate prevocational and/or vocational education should be provided just prior to these drop outs; and the potential

[4] Paul H. Bowman and Charles V. Mathews, *Motivations of Youth for Leaving School* (Washington: U. S. Office of Education, 1960), cooperative Research Project N. 200, p. 4-6. Note: This is a study of the school-leavers, Olney, Ill.

[5] Harold C. Dillon, *Early School Leavers* (New York: Nat. Child Labor Committee, October, 1949), Pub. No. 401.

drop-out student might be motivated to delay his withdrawal until he is vocationally prepared. Almost all students who terminate their formal education are potential job seekers. This is especially true of the male student. If he has been given vocational education for employment in an occupation where vacancies exist, it is very likely that his satisfactory employment will encourage others to delay school leaving.

The Drop Out Problem—In Conant's "Recommendation 1: Required Subjects for All Pupils in Grades 7 and 8," the following is quoted, "All girls should receive instruction in home economics and all boys instruction in industrial arts."[6] In describing the "usual sequential elective program" in "Recommendation 10: Program in Grade 9," he states further that "In grade 9, many pupils will keep up their interest in art, music, and industrial arts and at the same time commence an elective sequence that will lead to the development of a marketable skill."[7] In describing the vocational service needed in the junior high school, Conant reflects, "The nature of the industrial arts and home economics facilities does depend somewhat on the nature of the community and the consequent needs of the pupils. In areas where school drop outs are high, these departments have a responsibility to start the development of vocational skills."[8]

With respect to the American high school, Conant has the following to say about vocational occupational preparedness:

> The counselors should be sympathetic to the elective programs which develop marketable skills: . . .[9]
>
> For example, the policy of the school in regard to the vocational programs should be such as to insure that these programs are *not* used as dumping grounds for those of low academic ability.[10]
>
> Programs should be available . . . in typing, stenography, the use of clerical machines, home economics . . .[11]
>
> Distributive education should be available . . .[12]
>
> . . . agriculture should be included.[13]
>
> . . . trade and industrial programs should be available.[14]
>
> . . . introduce new vocational programs and opportunities open in the community or area.[15]
>
> . . . advanced programs of a technical nature should be developed . . .[16]
>
> the industrial arts courses can be considered as preparatory or exploratory courses.[17]

---

[6] James B. Conant, *Education in the Junior High School Years* (Princeton, N. J.: The Educational Testing Service, 1960), p. 16.
[7] *Ibid.*, p. 30.
[8] *Ibid.*, p. 32.
[9] James B. Conant, *The American High School Today* (New York: McGraw Hill, 1959), p. 45.
[10] *Ibid.*
[11] *Ibid.*, p. 52
[12] *Ibid.*
[13] *Ibid.*
[14] *Ibid.*
[15] *Ibid.*
[16] *Ibid.*
[17] *Ibid.*, p. 54.

Where local opportunities permit, students in some of the vocational programs may obtain experience by working on jobs outside the school. (Diversified Occupations.)[18]

Distributive education in some localities has been developed to a high degree.[19]

Although large population areas can afford separate vocational schools, Conant asks "What sort of high school program is left for those average students who for one reason or another, cannot attend . . . ?[20] He answers this to a degree by concluding, "However, if the state vocational authorities will agree, vocational programs can be distributed among the general high schools of a large city . . ."[21] This same question could be asked regarding the small city high school. And to a degree the answer could follow very well that Distributive Education and other cooperative programs such as Diversified Occupational Education might be added and distributed among the general high schools of small cities according to need.

Conant gives support to vocational education at the 9th and 10th grade levels due to the recognition that there are many potential drop outs in certain neighborhoods. To help these youth fit better into the employment picture is a "must" according to his words. He recognizes that this earlier program of vocational education must be a "simple type" and made up of "practical courses."[22]

A study of drop outs in the State of Illinois will show the grade level of school leavers. Whether or not educational objectives have been achieved, these students terminate their formal education and seek employment. Table 1 shows the numbers in school for each grade during the past ten years. Appearing opposite each number is the percentage of loss in each class by year. Migration and emigration affect these numbers. Deaths, retention in grades, errors in reporting, and many other factors affect them also. In spite of this, there are significant grade levels of student drop outs prior to the attainment of vocational preparedness. In Table 1, it will be noted that the grades 9, 10, 11, 12, and 13 mark the greatest losses. In comparison with Table 2 (based on national figures), Table 1 may tend to indicate that Illinois is doing slightly better in retention. Table 2 shows less than 60 percent of those registered in the fifth grade as completing high school in 1958. In Illinois it was about 66 percent of those registered in the ninth grade who completed high school in 1958. If the fifth grade numbers could have been produced, it is likely that Illinois would have ranked near the national average.

Some definite vocational preparedness should be made by these drop outs. The public schools should study the records of drop outs, learn to identify prospective drop outs and then prepare them for better occupations

[18] *Ibid.*
[19] Conant, *The American High School Today*, op. cit., p. 55.
[20] James B. Conant, *Slums and Suburbs* (New York: McGraw-Hill, 1961), pp. 48-49.
[21] *Ibid.*
[22] *Ibid.*, p. 52.

than they might be forced to take otherwise. For these students it would appear that much more vocational education should be added to the public school program and less college degree preparatory education should be required of them.

Some Influences of Vocational Education

Studies have been made showing that vocational education has retention values for potential school leavers. Chart 1 shows that among vocational education students, there were fewer drop outs than among other classes of high school students. It would appear that vocational education retains students, and by adding still more vocational education, general retention should be increased (see Chart 2).

TABLE 1
Estimated Retention Rates 9th Grade through College Entrance, State of Illinois

Year of Entrance into Ninth Grade	PERCENTAGE RETENTION 9th Grade	10th Grade	11th Grade	12th Grade	High School Graduates	Year of Graduation	First-Time College Students
1951-52	100	91.2	31.8	72.4	68.5	1955	29*
1953	100	94.2	83.4	73.0	68.4	1956	30*
1954	100	92.3	81.3	70.2	65.5	1957	30*
1955	100	92.0	82.0	71.2	66.4	1958	31†
1956	100	93.2	82.9	72.6	67.7	1959	32†
1957	100	94.2	84.0	72.6	68.4	1690	33†
1958	100	94.0	81.4	72.0†	68.0†	1961	33†
1959	100	91.2	82.0†	72.0†	68.0†	1962	34†
1960	100	92.0†	82.0†	72.0†	68.0†	1963	35†
1961	100	92.0†	82.0†	72.0†	68.0†	1964	36†
1962	100	93.0†	82.0†	72.0†	69.0†	1965	36†
1963	100	93.0†	83.0†	72.0†	69.0†	1966	37†
1964	100	93.0†	83.0†	72.0†	69.0†	1967	37†
1965	100	93.0†	83.0†	72.0†	70.0†	1968	38†
1966	100	93.0†	83.0†	72.0†	70.0†	1969	38†
1967	100	93.0†	83.0†	72.0†	70.0†	1970	39†

SOURCE: State of Illinois, Office of Public Instruction, Statistical Report, Superintendent of Public Instruction.
*National figures from U. S. Department of Health, Education, and Welfare, Office of Education. Biennial Survey of Education in U. S., 1956-58, Statistical Summary of Education.
†From estimates based on educational trends.

Offerings and Needs

According to earlier reports, it appears that the employment needs in the State of Illinois are about typical of the United States on a population basis.[23] This seems to substantiate a plan of vocational education for the

[23] *Vocational and Technical Education in Illinois—Tomorrow's Challenge, op. cit.*, p. 8.

TABLE 2

Estimated Retention Rates*, 5th Grade through College Entrance, in Public and Nonpublic Schools: United States (48 States and D.C.), 1923-31 to 1950-58

School year of entrance into 5th grade	5th† grade	6th grade	7th grade	8th grade	9th grade	10th grade	11th grade	12th grade	High School graduates	Year of high school graduation	First-time college students
1923-24	100	89	78	72	58	44	35	31	27	1931	12
1924-25	100	91	80	74	61	47	38	34	30	1932	12
1925-26	100	91	82	74	64	51	42	37	32	1933	11
1926-27	100	92	82	75	68	55	45	40	33	1934	13
1927-28	100	93	83	78	71	59	48	42	36	1935	14
1928-29	100	94	85	80	74	62	50	43	38	1936	14
1929-30	100	95	86	82	76	65	51	45	40	1937	14
1930-31	100	94	87	82	77	65	53	46	42	1938	15
1931-32	100	93	88	82	78	65	55	48	43	1939	15
1932-33	100	94	89	83	79	66	57	51	46	1940	16
1933-34	100	94	90	84	79	69	59	49	46	1941	14
1934-35	100	95	89	84	80	71	61	51	47	1942	13
1935-36	100	95	89	84	81	72	59	47	44	1943	12

1936-37	100	95	90	85	84	70	55	42	39	1944	12
1937-38	100	95	90	85	81	68	52	43	40	1945	‡
1938-39	100	96	91	85	80	66	53	44	42	1946	‡
1939-40	100	96	92	85	78	67	55	48	45	1947	‡
1940-41	100	97	91	84	78	70	57	51	48	1948	‡
1941-42	100	95	90	83	79	70	58	51	49	1949	‡
1942-43	100	95	91	85	81	71	60	54	50	1950	20
1943-44	100	97	91	87	83	74	63	56	52	1951	22
1944-45	100	95	93	86	85	75	65	55	52	1952	23
1945-46	100	96	94	88	87	77	66	55	52	1953	27
1946-47	100	95	94	92	87	78	64	58	55	1954	28
1947-48	100	97	95	92	86	75	67	59	56	1955	29
1948-49	100	98	96	93	86	80	71	62	58	1956	30
1949-50	100	98	97	92	87	80	70	61	57	1957	30
1950-51	100	98	97	92	89	81	71	63	58	1958	31

SOURCE: U. S. Office of Education, *Biennial Survey of Education*, "Statistical Summary of Education," Chapter I Statistical Summary of Education, OE 6003-58, 1957-58, p. 7.

*Rates for the 5th grade through high school graduation are based on enrollments in successive grades in successive years in public elementary and secondary schools, and are adjusted to include estimates for nonpublic schools. Rates for first time college enrollment are based on data supplied to the Office of Education by institutions of higher education.

†5th grade in 12-grade systems; 4th grade in 11-grade systems.

‡Lack of detailed information regarding veteran students makes the calculation of retention rates unreliable.

State not unlike one which might be devised for employment on a nation-wide basis. This is particularly convenient because the *variable of migration* may be disregarded.

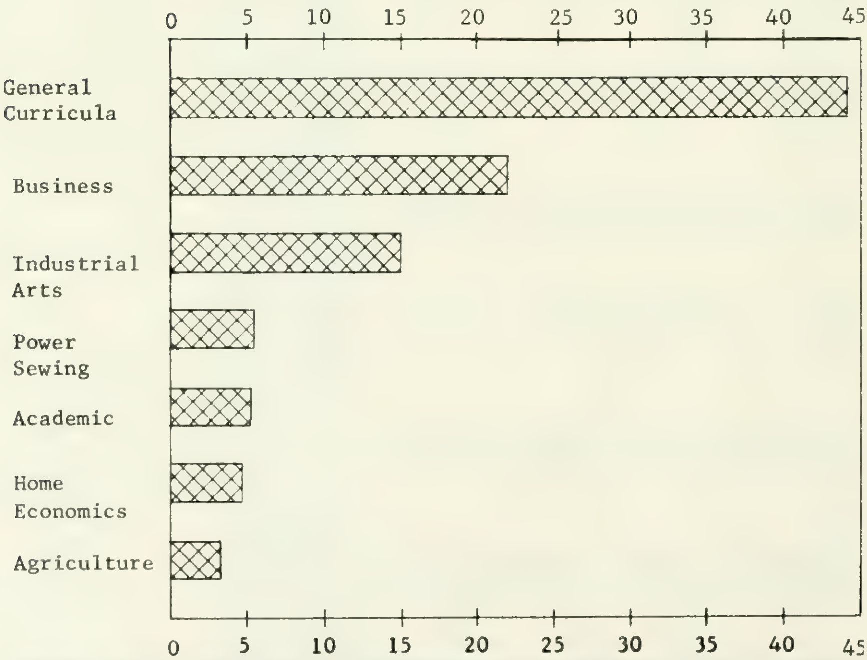
The areas of vocational education commonly offered in the public schools are as follows:

1. Agriculture
2. Distributive and Business
3. Homemaking
4. Trade and Industrial

These areas cover the typical families of occupations mentioned above which were listed as: (1) farmers and farm workers, (2) business and kindred workers, including office workers, managers, proprietors, clerks, and sales people, and (3) craftsmen, operatives, and service men including foremen, technicians, and kindred workers, skilled and semi-skilled. Homemaking education is primarily preparatory to the vocation of homemaking for girls in particular, but it may also be preparatory to certain business,

CHART 1

Retention Value of Vocational Versus Academic Courses
Based on Relative Percentage of Drop Outs



SOURCE: Stanley L. Raub, "Vocational Adjustment Problems of Middletown Youth; Implications for Improvements of the Secondary School Program in Middletown, New York." Unpublished Ed. D. Thesis, New York University, 1956.

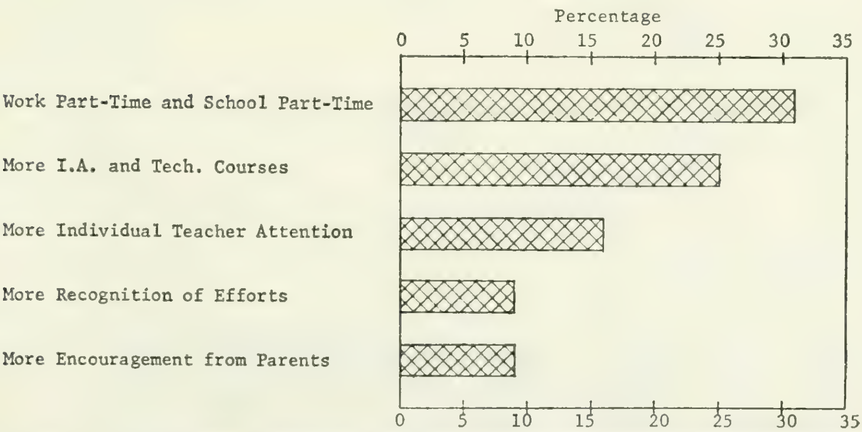
technical, and industrial occupations. Table 3 shows the enrollments in the above four areas of vocational education, from 1950 through 1961. Since 1959, specialized *technical* education has been developing at the 13th and 14th grade level. Comparison of these enrollments to the total vocation and vocational preparatory enrollments for three years would not be significant inasmuch as trends have not yet been established. Basically, these technical enrollments are in a separate class and apply specifically to (3) craftsmen, operatives, and service men, including foremen, technicians, and kindred workers, skilled and semi-skilled, above. The percentages in the above table are with reference to the total four-year high school population. This seems appropriate since a dropout of about 31⅓ percent occurs in the grades 9 through 12 (see Table 1). Illinois figures include only public school enrollments. On the national level only 42 percent of those enrolled in the fifth grade in 1950-51 actually graduated in 1958. These figures are based on public and nonpublic school enrollments (see Table 2).

Table 4 shows the distribution of occupational workers by the three families of occupations mentioned above. The percentages refer to the total number of gainfully occupied persons in Illinois during the years 1940 through 1960.

By comparing Table 3 with Table 4, Charts 3, 4, and 5, there is shown a disparity of the various vocational education programs in comparison to the actual occupational placement of adult workers. It must be remembered that home economics graduates may fill some of the three families of voca-

CHART 2

Relative Frequency of Various Opinions Held by Drop Outs
As to What Would Have Kept Them in High School



SOURCE: John A. Rogers, "Implications for Curriculum Resulting from a Study of Drop-Outs at Middletown, New York." Unpublished Ed. D. Thesis, The Pennsylvania State University, 1956.

TABLE 3

Total Served by Vocational Education

Year	Total Public High School Enrollment*	Agriculture†	%	Distributive Education†	%	Homemaking†	%	Trades and Industries†	%	Total Vocational†	%
1940	379,163	12,836	3.4	57	.02	26,224	6.9	9,827	2.6	48,944	12.9
1945	317,524	10,773	3.4	446	.14	20,547	6.5	8,204	2.6	39,970	12.6
1950	301,561	17,024	5.7	726	.2	25,738	8.5	6,582	2.2	50,070	16.6
1951	306,217	16,875	5.5	958	.3	27,961	9.1	6,198	2.0	51,992	16.9
1952	311,478	16,526	5.5	1,050	.3	31,744	9.9	5,993	2.0	55,313	17.7
1953	318,193	16,859	5.3	1,044	.3	33,351	10.5	6,474	2.0	57,728	18.1
1954	325,374	16,875	5.4	1,015	.3	32,901	9.9	6,220	1.9	57,011	17.5
1955	338,013	17,107	5.2	1,063	.3	34,687	9.9	6,750	2.1	59,607	17.5
1956	351,944	16,754	4.9	1,161	.3	35,976	9.9	6,575	1.9	60,466	17.0
1957	374,710	16,379	4.4	1,180	.3	37,159	9.9	6,453	1.7	61,171	16.3
1958	404,505	16,042	4.0	1,110	.3	38,137	9.4	7,454	1.8	62,743	15.5
1959	421,736	15,610	3.7	1,221	.3	38,658	9.2	8,037	1.9	63,526	15.1
1960	431,509	15,019	3.5	1,312	.3	36,149	8.4	8,302	1.9	60,782	14.1
1961	....	15,005		1,595		36,143		8,484		61,227	

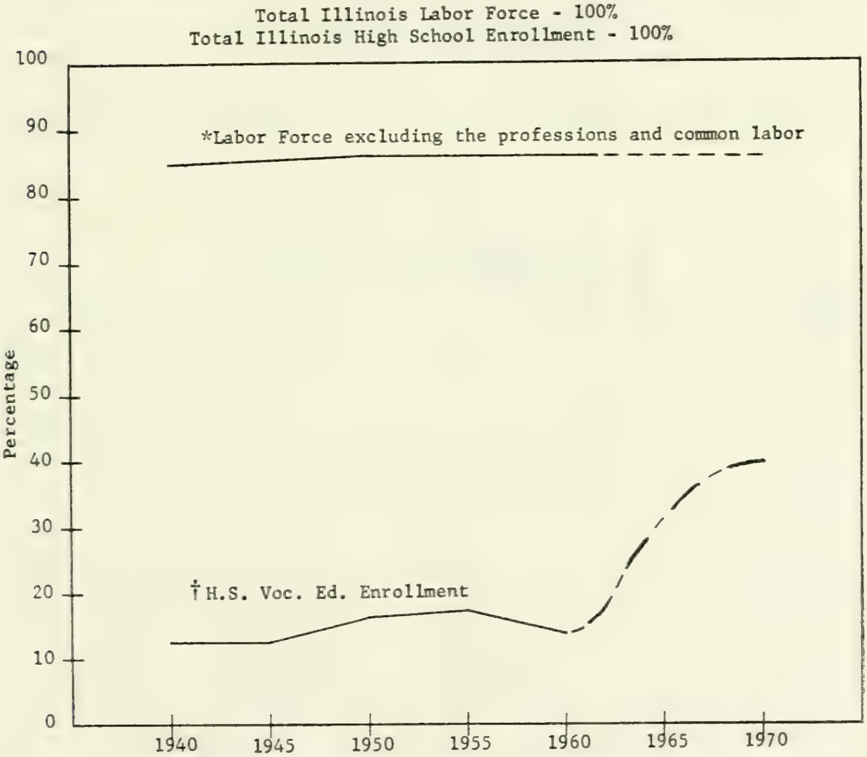
SOURCE: *State of Illinois, Office of Public Instruction. Statistical Report, Superintendent of Public Instruction.
†State of Illinois, Board of Vocational Education. Annual Report; Vocational Educational Division 1960-61, Series B Bulletin No. 183.

tional occupations described in the three charts. These charts may be used as guides, however, to future program planning. From an over-all standpoint, for example, it might be said that much more vocational education should be added to the public school programs. Table 4-A is significant in that it shows a great need for vocational education at the ninth through twelfth grade levels.

Since the four areas above may not cover well the various families of occupations, possibly the Diversified Occupations program in trade and industries and Distributive and Business Education should be expanded,

CHART 3

Comparison of Illinois Public High School Total Vocational Education Day School Enrollment with Total Illinois Labor Force



SOURCE: U. S. Bureau of the Census. U. S. Census of Population, 1960. General Population Characteristics, Illinois. Final Report PC (1)-158.
*State of Illinois, Department of Labor. Illinois Labor Bulletin, "Occupational Changes in Illinois Labor Force, 1955-1965," Vol. 20, No. 5.
†State of Illinois, Office of Public Instruction. Statistical Report, Superintendent of Public Instruction.
State of Illinois, Board of Vocational Education. Annual Reports; Vocational Educational Division 1960-1961, Series V Bulletin No. 183.

NOTE 1: Dotted line (- - - - -) indicates probable trends.

NOTE 2: Broken line (— — —) indicates probable needs.

TABLE 4

Distribution of Labor Force in Illinois*

Year	Total Labor Force	%	Prof. Tech. and Kindred	%	Farmers and Farm Workers	%	Business Sales and Kindred	%	Craftsmen Operatives and Service	%	Common Labor	%	Occupation Not Reported	%
1940	..2,862,731	100	245,078	8.6	279,841	9.8	850,822	29.6	1,179,917	41.0	282,480	9.8	24,593	1.2
1950	..3,544,583	100	317,507	9.0	244,352	6.9	1,114,280	31.4	1,568,735	44.2	255,576	7.2	44,133	1.3
1960	..3,899,472	100	417,477	10.5	162,142	4.2	1,233,409	32.0	1,611,166	41.2	229,742	5.9	245,536	6.2
1970	..4,670,000	100	572,000†	12.2	137,500†	3.0	1,542,500†	33.0	1,934,000†	41.4	222,500†	4.8	261,500‡	5.6

SOURCE: U. S. Bureau of the Census, U. S. Census of Population. General Social and Economic Characteristics, Illinois, Final Report PC (1)—15C.
*Estimate based on the prediction of a 20% increase in population.
†Estimates based on "Occupational Changes," Illinois Labor Bulletin, Vol. 20, No. 5, April 1960, pp. 8-9.
‡Estimated.

especially in small schools where the various separate areas cannot be justified. Diversified Occupations programs for the fiscal year 1960-61 totaled 46. There were 829 students in these programs in 1960-61. Seventy-two percent of the students who graduated in 1960 were placed in the occupations, or allied occupations, for which they were trained.[24] (See Charts 7 and 8).

Part-Time and Other Short-Term Vocational Education

In Illinois the various areas of vocational education have part-time programs for out-of-school youth and adults. Agricultural Education is provided for "young" farmers and for the "adult" farmer. Further, the Future Farmers of America, veterans training, and supervised farm practice are out-of-school programs. The Business and Distributive Education Division sponsors the Illinois Association of Future Distributors of America. Trade and Industrial Education conducts evening trade preparatory and part-time General Continuation programs (see Table 7).

From the federal government, monies are available for the reimbursement of these programs and an increased need for training and retraining is being recognized. Through the Area Redevelopment Act of 1962, other

TABLE 4-A

Average Years of School Completed of Those Working in 1959

OCCUPATION GROUP	YEARS
Professional and Technical	16.2
Proprietors and Managers	12.4
Clerical and Sales	12.5
Skilled	11.0
Semi-skilled	9.9
Service	9.7
Unskilled	8.6
Farmers and Farm Workers	8.6

SOURCE: U. S. Department of Labor Statistics and Bureau of Employment Security, *Manpower Challenges of the 1960's*, The Department, Washington, D.C., 1960, p. 11.

monies are being made available. This seems to be a step to correct the unemployment problems on a nationwide basis. An example of the operation of such a program is shown in Table 8. Some 73 people were trained at an average cost of $271.41 per person. Upon completion of the training, immediately after placement, these people no longer drew relief checks or unemployment compensation. Immediately, also, many became taxpayers and began to pay back in taxes their debts to society for the training received.

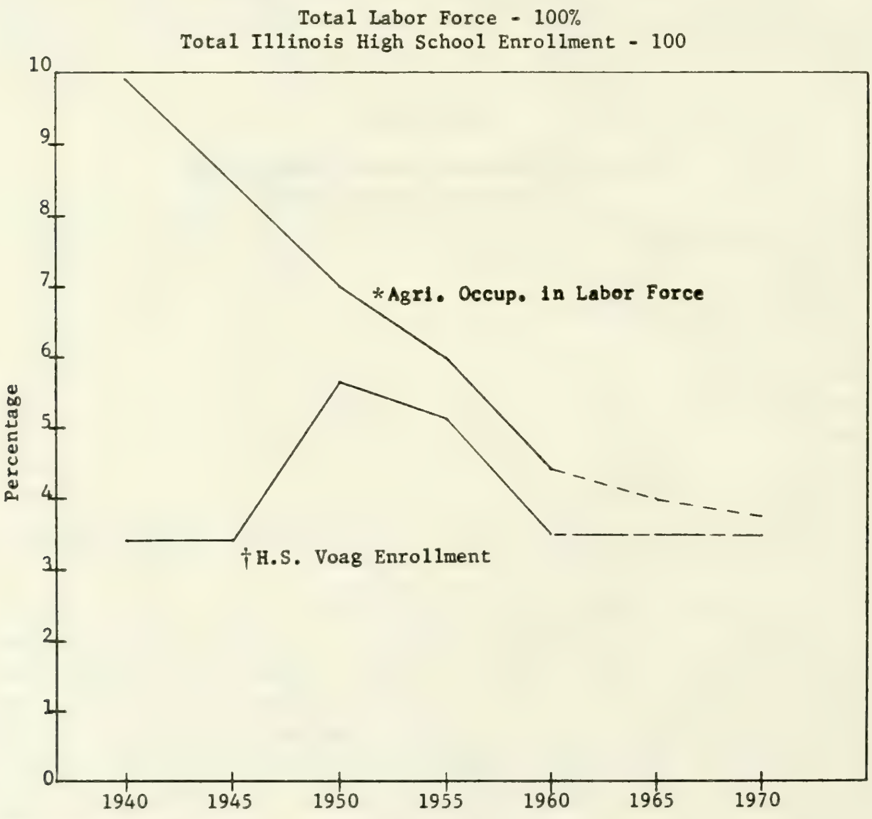
[24] State of Illinois Annual Report, Vocational Education Division, July 1, 1960-June 30, 1961, Series B—Bul. 183, Oct., 1961; State of Illinois Board of Vocational Education, *Distributive Education Leads to Gainful Employment*," Series B—Misc. No. 23-B.

From the illustration above it should be obvious that full-time manpower development training pays. States should develop training programs as fast as surplus labor areas are discovered. As in the illustration above, many such communities could have training facilities moved into the area in order to minimize the individual trainee's travel expense.

Obviously, some programs of vocational education or prevocational education should begin at an earlier period than the 11th and 12th grades. By that time we have already lost by drop out about 30 percent of our children of this age level (see Table 2). Along with the general education appropriate to preparation for life in our democratic society, vocational education can be provided. This has been done in the past, mostly at the

CHART 4

Comparison of Illinois Public High School Day School Enrollments in Voag to Agriculture Occupations in the Illinois Labor Force



SOURCE: Same as Chart 3.
NOTE 1: Dotted line (-----) indicates probable trends.
NOTE 2: Broken line (— ——) indicates probable needs.

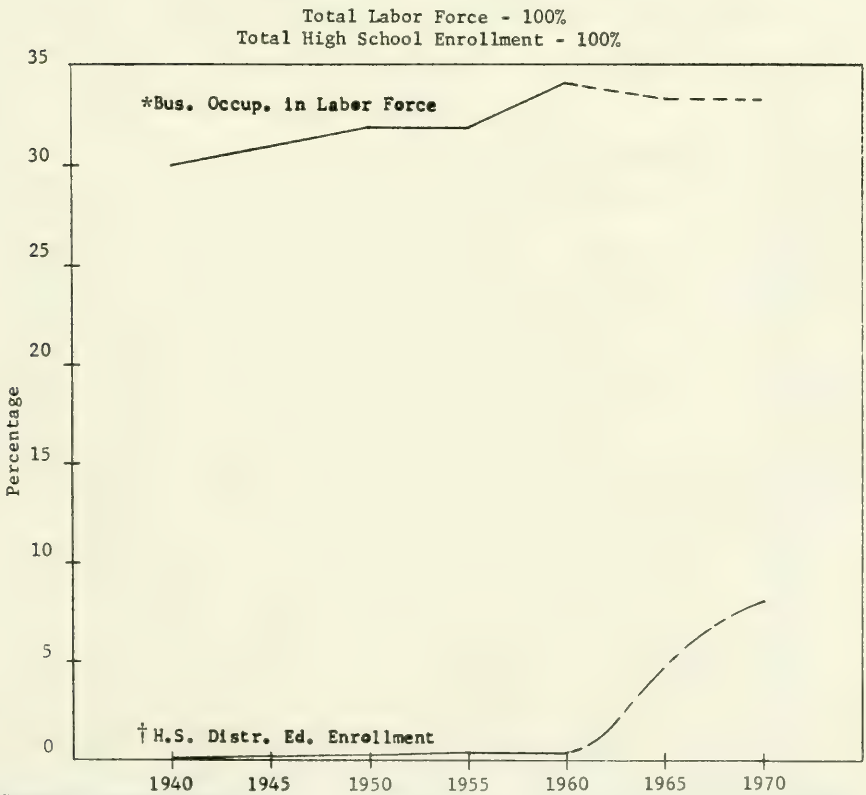
11th and 12th grade levels. However, only 14 percent of all enrollees were being prepared in 1960-61 on all levels of the four-year high school. Upon graduation in 1960, it is estimated that less than 50 percent of the graduates proceeded to college. From these statistics it should be clear that there is a wide disparity between those who were prepared for college and those who actually entered college. It should be clear also that there is a shocking disparity between those who were prepared for occupations and those who were actually mustered into the world of work.

Unmet Needs

Pursuant to technological change, there is unemployment. A provision for retraining is an immediate responsibility of our society. Federal financial aid should be sought, but retraining should be started immediately. Ma-

CHART 5

Comparison of Illinois Public High School Day
Enrollments in Distributive Education to Business Occupations
in the Illinois Labor Market



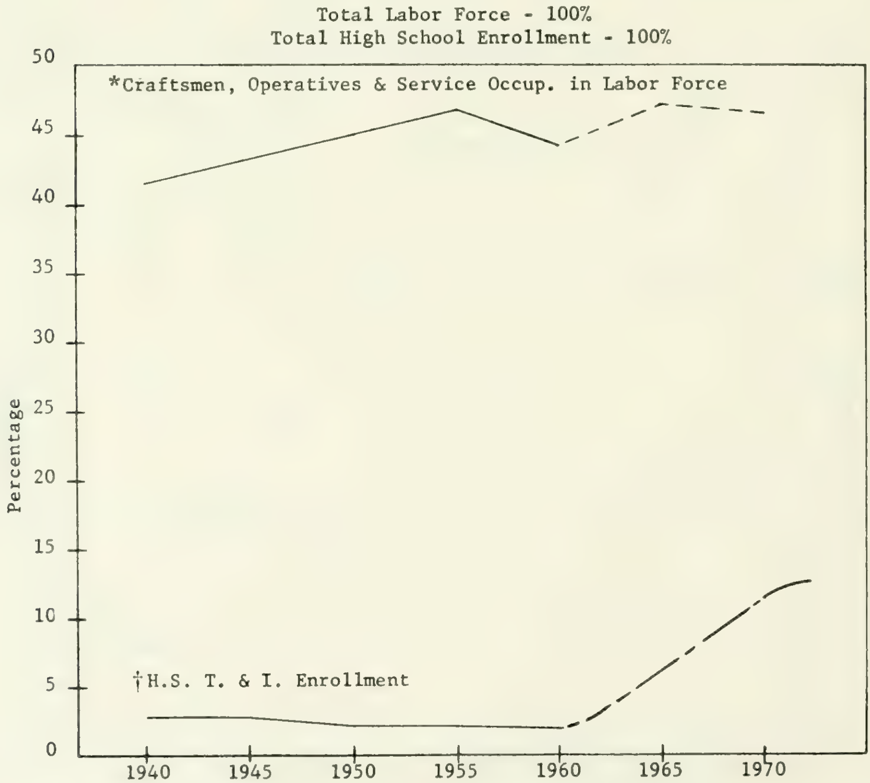
SOURCE: Same as Chart 3.
NOTE 1: Dotted line (- - - - -) indicates probable trends.
NOTE 2: Broken line (— — —) indicates probable needs.

chinery in the Vocational Education Office for this retraining should be ready for emergencies. Funds should be provided either on a matched or unmatched basis, by the states, for initiating and maintaining this training.

The public school program of vocational education does not meet the needs of a majority of students. It is not geared to the manpower needs of the State and it does not provide vocational preparedness to many of those who drop out prior to and immediately after high school graduation. A selected few are being given vocational education in accordance with traditional patterns. Many others who should have a modern, more versatile

CHART 6

Comparison of Illinois Public High School Day Enrollments in Trades and Industries Education to Craftsmen, Operatives, and Service Occupations in the Illinois Labor Force



SOURCE: Same as Chart 3.
NOTE 1: Dotted line (- - - - -) indicates probable trends.
NOTE 2: Broken line (— — —) indicates probable needs.

vocational education are not being identified and guided into any vocational preparedness program.

Projections — 1960-70

Assumptions.—In order to make projections of cost based on needs, there are several assumptions which may be made. Problems of federal support, state and local capabilities, and the dollar value in years to come are but a few. Projections from other sources are available, but all are variables and cannot be controlled. A few assumptions are listed as a basis for the projections which follow.

1. The percentage of federal-state support for vocational education has varied over the past ten years. The ratio has been approximately 40 percent federal to 60 percent State. The assumption is made that this ratio will continue.

2. Costs can be projected on the dollar value of 1960. Any change in this rate can be taken into account in estimating later.

3. Between one-third to four-tenths of students entering high school will continue with some kind of formal education after high school gradua-

TABLE 5

Diversified Occupations— A Follow-up Report on Day Trade Students in Illinois (1959 and 1960 Graduates)

Description	1959 (number or percent)	1960 (number or percent)
Number of Graduates	381	453
Entered Military Service	63	79
Continued Formal Education	37	40
Employable	281	334
Employed in Occupation:		
For which Trained	195	242
Percent	69%	72%
Allied to Training	23	17
Percent	9%	5%
Unrelated to Training	60	53
Percent	21%	16%
Unemployed	2	18
Percent	2/3%	6%
Unknown	1	4
Percent	1/3%	1%

SOURCE: Reported by V. E. Burgner, Chief, Research and Statistics, Board for Vocational Educational Education, State of Illinois, Sept. 1960—Refers to all Diversified Occupations programs in Illinois.

tion and before entering a vocation.

4. Between six-tenths to two-thirds of all students entering high school will drop out or graduate and seek a vocation on the basis of this meager education. Over 30 percent will drop out before graduation.

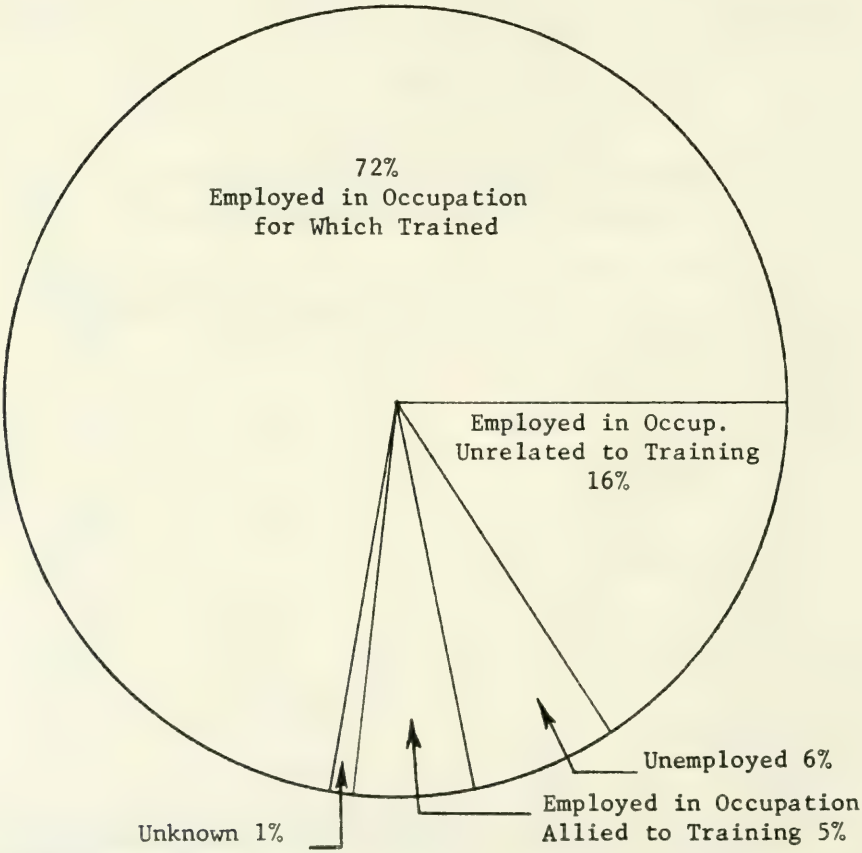
5. Between 35 percent and 40 percent, at least, of Illinois high school youth should be in some kind of occupational skill development education up to the time they drop out or graduate. At present, about 14 percent are permitted to take some kind of vocational education.

6. Labor force predictions for the decade 1960-70 should be a guide to vocational education programs for those who are in the public schools.

7. Technical education beyond the high school will develop slowly in

CHART 7

A Follow-Up Study of Those Graduates of Diversified Occupations Considered "Employable"



SOURCE: Same as Table 5.

the decade 1960-70, although a significant move will be made to facilitate this development.

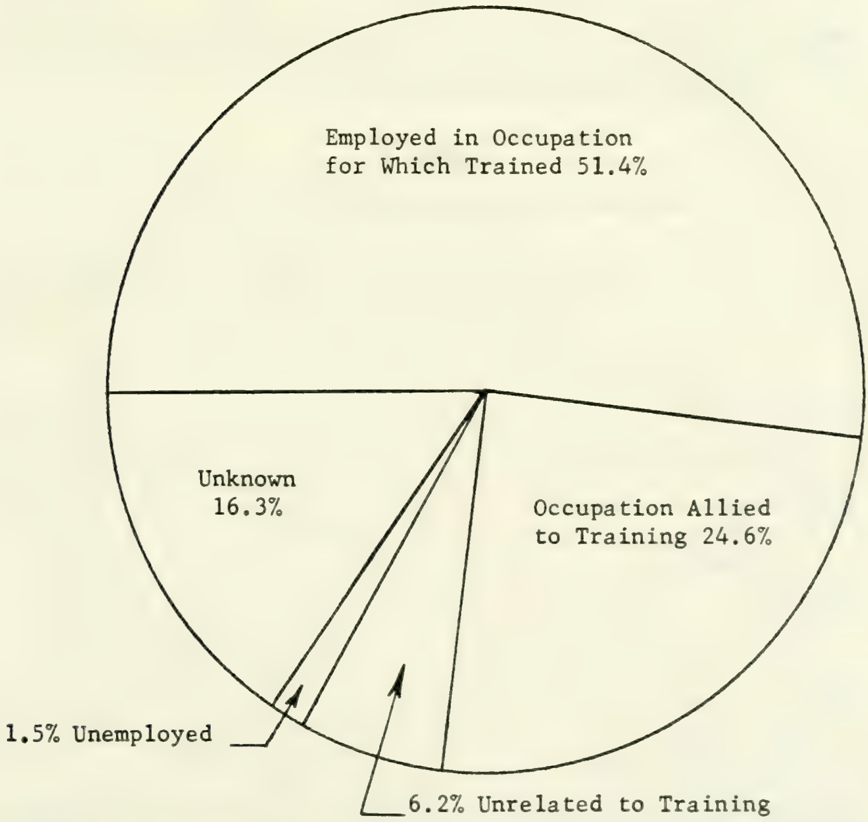
8. The high school student population will increase about 29.7 percent during the decade 1960-70. (see Chart 9).

9. Illinois, like the other six most populous states in the union, has similar cost problems in financing vocational education. And a fair estimate of "low," "medium," and "high" costs can be obtained by comparing these states with each other.

10. "Multipliers" based on the costs in other states can be developed with reference to costs in Illinois whereby one might project "low," "medium," and "high" costs.

CHART 8

A Follow-Up Study of Those Graduates Of Distributive Education Considered "Employable"



SOURCE: State of Illinois, Board of Vocational Education, "Distributive Education Leads to Gainful Employment," Series B—Misc. No. 23-B.

Comparative Costs.—The seven most populous states in the United States are compared in Tables 10, 11, 12, and 13. This was done in order to arrive at the "low," "medium," and "high" costs. The medium in this case simply represents a figure between the highest and lowest number. The multipliers represent the Illinois cost percentage of the high, medium, and low cost figures.

TABLE 7

Out of School Programs

	Agriculture (Part-Time & Evening)		Distr. Education (Part-Time & Evening Ext.)		Homemaking (Part-Time & Evening)		Trades & Indus. (Part-Time, Evening, & General Cont.)		All Areas	
Year	No.	%	No.	%	No.	%	No.	%	Total No.	Total %
1930 ...	1,625	5.7		0	3,344	11.8	23,324	82.5	28,293	100
1940 ...	5,785	18.5	4,419	14.1	2,883	9.2	18,164	58.2	31,251	100
1950 ...	7,997	17.6	4,763	10.4	13,065	28.8	19,626	43.2	45,451	100
1960 ...	10,860	21.95	3,012	16.43	13,426	27.15	22,177	44.9	49,475	100

SOURCE: State of Illinois, Board of Vocational Education. Annual Report. Vocational Educational Division 1960-1961, Series B Bulletin No. 183.

TABLE 8

ARA Adult Retraining Costs in Illinois

	Cost of Training	Average Cost
Clerk-Typists		
15 ...	$ 6,032.28	$402.15
(Litchfield)		
Clerk-Stenographers		
24 ...	6,032.28	251.34
(Litchfield)		
Welders		
10 ...	3,382.89	338.29
(Taylorville)		
Nurses' Aids		
19 ...	2,203.22	115.95
(Taylorville)		
Cooks		
5 ...	2,162.52	432.50
(Litchfield)		
TOTAL ...	$19,813.19	$271.41

SOURCE: Reported by V. E. Burgner, Chief, Research and Statistics, Board for Vocational Education, State of Illinois, Sept. 28, 1962—Refers to ARA programs of adult education completed in Litchfield and Taylorville, Illinois prior to date.

In the area of vocational agricultural education, Illinois ranks between the medium and low cost levels. The multiplier for low is .80 of the Illinois cost. For the medium or mid-point, the multiplier is 1.08. And for the high level, the figure is 1.35 times the Illinois cost.

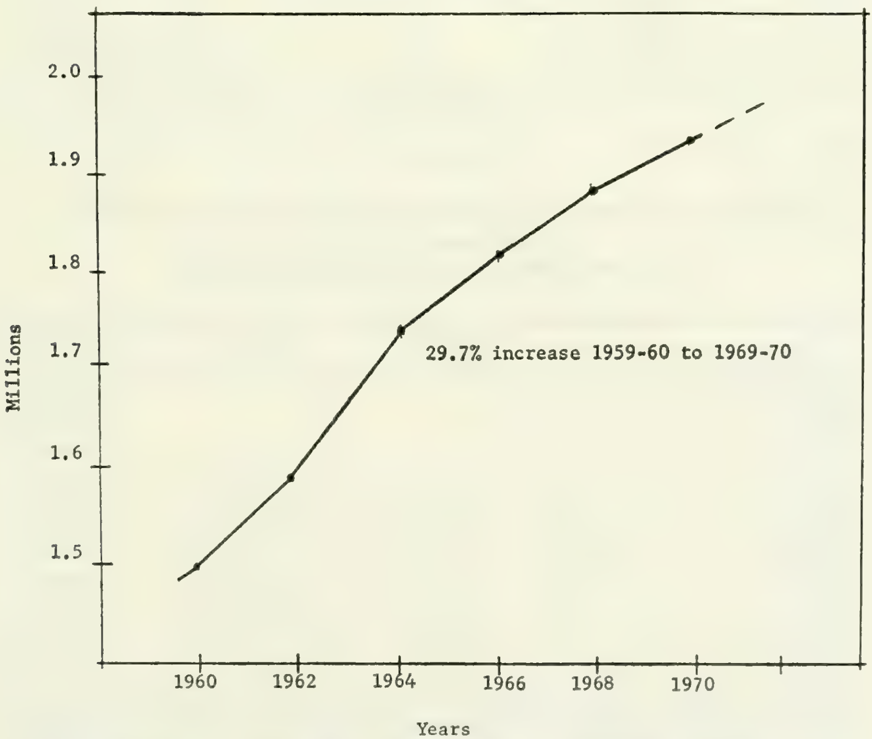
For vocational distributive education, there was an extremely low figure for per pupil cost in California. In computing the multipliers, .265, .822, and .137, this extreme figure was disregarded.

Another low figure for New York's vocational home economics per pupil cost was disregarded in computing the multipliers, .438, .72, and 1.0 for this area. The 1.0 high multiplier indicates that Illinois spends more for vocational home economics per student than any of the other six most populous states.

Trade and industrial per pupil cost multipliers were found to be .57, low; .88, medium; and 1.20, high.

CHART 9

Projected Average Daily Attendance of Public School Students 1960-1970



SOURCE: *Estimates of Public School Statistics* 1960-61. Washington: National Education Association, p. 30.

Projected State Appropriations.—Tables 14, 15, 16, and 17 represent the state's share in financing vocational education in the various areas, excluding technical education. These figures represent the cost of state supervision and the projected increase or decrease in enrollment figures for each area. To arrive at the "low," "medium," and "high" costs the above multipliers were used.

The enrollments in agriculture and the agricultural labor force are expected to decrease steadily about 15 percent in the next decade.

TABLE 9

Approximate Cost per Student for the Biennium 1959-1961 from State Appropriations for Vocational Education

Vocational Area	Average Number of Participating Students	Funds From State Appropriations	Average Biennium Cost Per Student	Average Annual Cost Per Student
Agriculture	25,877	$1,503,531.41	$58.10	$29.05
Distributive Education ..	4,679	164,664.62	35.10	17.55
Home Economics	50,214	1,781,121.39	35.47	17.74
Trades and Industries ..	30,257	1,592,159.52	52.62	26.31
Average student costs			$45.32	$22.66

SOURCE: State of Illinois, Board of Vocational Education, Annual Report, Vocational Educational Division 1960-1961, Series B Bulletin No. 183.

TABLE 10

Comparative per Pupil Costs of Vocational Agricultural Education—1959

Seven Most Populous States Including Illinois

	Total Number Served	Total Expenditures	Per Pupil Average Costs
High			$159.00
Medium			126.50
Low			94.00
Illinois	26,067	$3,060,227.19	117.50
California	18,629	2,469,646.20	132.30
Michigan	17,550	1,648,450.56	94.00
New York	10,232	1,625,494.16	159.00
Ohio	21,138	2,393,692.10	113.25
Pennsylvania	13,803	2,081,465.01	150.75
Texas	63,451	7,500,620.75	118.00

SOURCE: U. S. Department of Health, Education, and Welfare, "Vocational Education in the Next Decade," 1961.

NOTE: To compare Illinois with the Low, Medium and High cost levels, the multipliers are .80, 1.08, and 1.35, respectively.

To help fill the void in preparing people for distributive and business occupations, it is thought desirable to increase enrollment about 36 times. Along with the increase in student population this means that about 8.3 percent of the student population instead of the present .03 percent will receive this education.

TABLE 11

Vocational Distributive Education

	Total Number Served	Total Expenditures	Per Pupil Average Costs
High			$109.50
Medium			65.35
Low			21.20
Illinois	4,141	$ 332,237.76	80.00
California	84,522	767,930.57	9.10*
Michigan	15,540	515,110.34	33.10
New York	8,109	888,493.32	109.50
Ohio	11,001	344,047.54	31.60
Pennsylvania	7,014	395,632.60	56.80
Texas	45,811	973,762.33	21.20

SOURCE: Same as Table 10.
*Extreme figure not used in estimating High, Medium and Low.
NOTE: To compare Illinois with the Low, Medium and High cost levels, the multipliers are .265, .822 and 1.37, respectively.

TABLE 12

Vocational Home Economics Education

	Total Number Served	Total Expenditures	Per Pupil Average Costs
High			$ 64.00
Medium			46.00
Low			28.00
Illinois	53,373	$3,409,861.28	64.00
California	136,416	3,831,211.94	28.00
Michigan	48,949	2,371,099.18	57.20
New York	87,397	770,281.31	8.30*
Ohio	36,178	1,944,511.84	58.80
Pennsylvania	33,435	1,678.957.34	50.20
Texas	140,472	8,324,706.38	57.60

SOURCE: Same as Table 10.
*Extreme figure not used in estimating High, Medium, and Low.
NOTE: To compare Illinois with Low, Medium and High cost levels, the multipliers are .438, .72 and 1.0 respectively.

TABLE 13

Vocational Trade and Industrial Education

	Total Number Served	Total Expenditures	Average Costs
High			$101.00
Medium			74.50
Low			48.00
Illinois	29,163	$2,433,140.69	84.20
California	124,472	6,776,841.64	54.40
Michigan	42,410	2,866,612.86	67.60
New York	99,765	8,663,936.22	87.00
Ohio	37,400	2,621,133.66	70.20
Pennsylvania	50,525	5,097,593.83	101.00
Texas	48,432	2,341,456.66	48.00

SOURCE: Same as Table 10.
NOTE: To compare Illinois with the Low, Medium and High cost levels, the multipliers are .57, .88, and 1.20, respectively.

TABLE 14

Projected State Appropriations for Vocational Agriculture Costs Based on Population Trends and Needs
(Annual Costs)

		Programs of the Day School	Programs for Out of School persons	Total
1960-1961		$726,000.00*	$61,700.00*	$787,700.00*
1962-1963		726,000.00†	61,700.00†	787,700.00†
	High	776,000.00‡	64,900.00‡	840,900.00‡
1964-1965	Med.	620,000.00‡	51,900.00‡	671,900.00‡
	Low	452,000.00‡	38,450.00‡	497,450.00‡
	High	748,000.00‡	62,300.00‡	810,300.00‡
1966-1967	Med.	598,000.00‡	49,800.00‡	647,800.00‡
	Low	444,000.00‡	36,900.00‡	480,900.00‡
	High	722,000.00‡	60,400.00‡	782,400.00‡
1968-1969	Med.	580,000.00‡	48,400.00‡	628,400.00‡
	Low	430,000.00‡	35,700.00‡	465,700.00‡
	High	694,000.00‡	58,700.00‡	752,700.00‡
1970-1971	Med.	560,000.00‡	46,700.00‡	606,700.00‡
	Low	426,000.00‡	34,800.00‡	460,800.00‡

*State of Illinois, Board of Vocational Education. Annual Report; Vocational Educational Division 1960-1961; Series B Bulletin No. 183.
†Estimated.
‡Estimates based on predicted needs and multipliers.
NOTE: These figures are rounded and include supervision at the State level (about 11.6%) and are about 60% of the Federal and State funds used, the State's share being approximately three-fifths or 60%.

In vocational home economics there was no predictive data available on needs for increase or decrease. Therefore, the matter of student population increase alone was used as an index.

For the trade and industrial area the index for increase was population growth plus a fulfillment of needs to increase to 11.5 percent the number to be served. The present number being served is 1.9 percent. This is an increase of 6 times the present offering.

By adjusting to meet the needs of the labor market more accurately in the above areas, a total of approximately 30 percent of the student population may be served. This is still far below the apparent needs, but it seems logical to move this far in one decade.

Table 18 is a summary of Tables 14, 15, 16, and 17, and it shows the total estimated costs per biennium.

TABLE 15

Projected State Appropriations for Vocational Distributive Education Costs Based on Population Trends and Needs

(Annual Costs)

		Programs of the Day School	Programs for Out-of-School Persons	Annual Total
1960-61	....	$ 74,500.00*	$ 13,125.00*	$ 87,625.00*
1962-63	....	74,500.00†	13,125.00†	87,625.00†
	High	851,500.00‡	175,000.00‡	1,026,500.00‡
1964-65	Med.	508,100.00‡	155,200.00‡	663,300.00‡
	Low	164,700.00‡	35,300.00‡	200,000.00‡
	High	1,900,000.00‡	352,000.00‡	2,252,000.00‡
1966-67	Med.	1,133,000.00‡	207,000.00‡	1,340,000.00‡
	Low	367,000.00‡	63,000.00‡	430,000.00‡
	High	2,980,000.00‡	501,000.00‡	3,481,000.00‡
1968-69	Med.	1,770,000.00‡	299,000.00‡	2,069,000.00‡
	Low	570,000.00‡	98,000.00‡	668,000.00‡
	High	3,685,000.00‡	658,000.00‡	4,343,000.00‡
1970-71	Med.	2,190,000.00‡	387,000.00‡	2,577,000.00‡
	Low	712,000.00‡	137,000.00‡	849,000.00‡

SOURCE: Same as Table 14.
*State of Illinois, Board of Vocational Education. Annual Report; Vocational Educational Division 1960-1961; Series B Bulletin No. 183.
†Estimated.
‡Estimates based on predicted needs and multipliers.

TABLE 16

Projected State Appropriations for Vocational Home Economics Education Costs Based on Population Trends and Needs
(Annual Costs)

		Programs of the Day School	Programs for Out-of-School Persons	Annual Total
1960-61	....	$ 874,000.00*	$ 70,900.00*	$ 944,900.00*
1962-63	....	874,000.00†	70,900.00†	944,900.00†
	High	948,832.00‡	77,932.00‡	1,026,764.00‡
1964-65	Med.	648,000.00‡	66,100.00‡	740,100.00‡
	Low	415,500.00‡	34,100.00‡	449,600.00‡
	High	1,023,714.00‡	84,964.00‡	1,108,678.00‡
1966-67	Med.	737,000.00‡	61,200.00‡	798,200.00‡
	Low	448,000.00‡	37,400.00‡	485,400.00‡
	High	1,061,130.00‡	88,480.00‡	1,149,610.00‡
1968-69	Med.	764,000.00‡	63,800.00‡	827,800.00‡
	Low	464,500.00‡	38,750.00‡	503,250.00‡
	High	1,098,500.00‡	92,000.00‡	1,190,500.00‡
1970-71	Med.	791,000.00‡	66,200.00‡	857,200.00‡
	Low	481,000.00‡	40,300.00‡	521,300.00‡

SOURCE: Same as Table 14.
*State of Illinois, Board of Vocational Education. Annual Report; Vocational Educational Division 1960-1961; Series B Bulletin No. 183.
†Estimated.
‡Estimates based on predicted needs and multipliers.
NOTE: Since placement in occupational pursuits basic to this training cannot be shown among the labor forces, the estimated needs are based upon the expected enrollment growth as the population increases.

TABLE 17

Projected State Appropriations for Vocational Trade and Industrial Education Costs Based on Population Trends and Needs
(Annual Costs)

		Programs of the Day School	Programs for Out-of-School Persons	Annual Total
1960-61	....	$ 387,000.00*	$ 470,500.00*	$ 857,500.00*
1962-63	....	387,000.00†	470,500.00†	857,500.00†
	High	1,875,000.00‡	2,275,000.00‡	4,150,000.00‡
1964-65	Med.	1,374,337.00‡	1,669,666.00‡	3,044,003.00‡
	Low	890,000.00‡	1,080,000.00‡	1,970,000.00‡
	High	3,290,000.00‡	3,975,000.00‡	7,265,000.00‡
1966-67	Med.	2,412,174.00‡	2,929,832.00‡	5,342,006.00‡
	Low	1,562,500.00‡	1,895,000.00‡	3,457,500.00‡
	High	3,990,000.00‡	4,850,000.00‡	8,840,000.00‡
1968-69	Med.	2,931,093.00‡	3,559,915.00‡	6,491,008.00‡
	Low	1,898,000.00‡	2,305,000.00‡	4,203,000.00‡

Table 17 continues on page 271

TABLE 17 (Continued)

	High	4,760,000.00‡	5,785,000.00‡	10,545,000.00‡
1970-71	Med.	3,490,000.00‡	4,240,000.00‡	7,730,000.00‡
	Low	2,260,000.00‡	2,748,000.00‡	5,008,000.00‡

SOURCE: Same as Table 14.
*State of Illinois, Board of Vocational Education. Annual Report; Vocational Educational Division 1960-1961; Series B Bulletin No. 183.
†Estimated.
‡Estimates based on predicted needs and multipliers.

TABLE 18

Projected State Appropriations for Vocational Education Costs Based on Population Trends and Needs

	Day School	Out-of-School	Total (Annual)	Total (Biennium)
1960-61 Annual	$ 2,061,500.00	$ 616,225.00	$2,677,725.00	
				$ 5,355,450.00
1962-63 Annual	2,061,500.00	616,225.00	2,677,725.00	
1963-65 High	8,902,664.00	5,185,664.00		14,088,328.00
(Biennium) Med.	6,372,874.00	3,865,732.00		10,238,586.00
Low	3,858,400.00	2,375,700.00		6,234,100.00
1965-67 High	13,923,428.00	8,948,538.00		22,871,956.00
(Biennium) Med.	9,760,348.00	6,495,664.00		16,256,012.00
Low	5,643,000.00	4,064,600.00		9,707,600.00
1967-69 High	17,506,260.00	10,999,760.00		28,486,020.00
(Biennium) Med.	12,091,860.00	8,020,700.00		20,112,560.00
Low	6,725,000.00	4,555,900.00		11,679,900.00
1969-71 High	20,475,000.00	13,187,400.00		33,662,400.00
(Biennium) Med.	14,062,000.00	9,479,800.00		23,541,800.00
Low	7,758,000.00	5,920,200.00		13,678,200.00

SOURCE: Same as Table 14.
NOTE: In this table, technical education above the high school level is not included. Trends and needs were not well established at the time of this study. Hence, any judgment presented here would be highly invalid.
All figures above are estimates with the exception of the 1960-61 annual costs.

TABLE 19

Public High School Districts Offering Vocational Programs in Illinois

Programs	No. of Districts	Percentage
(Unit Dist. 358*)		
Total (H.S. Dist. 258*)	616*	100.0%
Agricultural Education	464†	75.0%
Business and Distributive Ed.	44†	7.2%
Home Economics Ed.	533†	90.0%
Trade and Industrial Ed.	95†	15.4%

*Estimates based on: State of Illinois, "Illinois School Problems," Commission No. 6, March, 1961.
†State of Illinois, Board of Vocational Education, Annual Report, Vocational Education Division, 1960-61, Series B Bulletin No. 183.

CHAPTER VI

STATE HIGHWAY EXPENDITURES

By Ronald L. Racster*

Administrative Highway Systems

The largest single expenditure by the state government of Illinois in each year since 1952 has been for highways and highway-related purposes. Highway expenditures of the state government are administered by the Deparment of Public Works and Buildings, which has general supervision of the state highway system and highways constructed or maintained in whole or in part with state or federal funds. State highway expenditures are dispersed for the construction, maintenance and operation of Illinois highways according to legislative provisions and contracts among highway authorities that define the channels of Illinois highway administration and finance.

Administrative highway systems were defined by the 1959 Illinois Highway Code, which in general placed highways under the jurisdiction of state, county, township and road district, and municipal highway authorities depending upon the government unit responsible for maintenance of the facility.[1] The state highway system is under the jurisdiction of the Illinois Division of Highways, a division of the Department of Public Works and Buildings, and includes rural highways and their municipal extensions constructed as part of the state bond issue system under the 1917 and 1923 State bond issues; federal-aid interstate and federal-aid primary highways constructed under the provisions of the 1916 Federal Aid Road Act and supplemental Acts, including toll highways; federal-aid secondary and state-aid roads which are maintained by the Division of Highways; highways constructed by the Division pursuant to Acts of the General Assembly prior to 1959; and beltline highways and certain other roads maintained by the Division of Highways. The state highway system established by the 1959 code is essentially analogous to the primary highway system, a non-legislative classification adopted by the Division of Highways to indicate facilities under their jurisdiction. In addition to the non-legislative "primary highway system," however, the state highway system includes about 2,200 miles of county highways constructed under the 1913 State-aid Act and a small mileage of special legislative highways.

The Division of Highways maintains all highways in the state highway system either directly with its own forces or by contract with counties or

---

*The author is an Assistant in Finance at the University of Illinois. The author gratefully acknowledges assistance rendered by Messrs. Theodore F. Morf and Fred Shaneman of the Bureau of Research and Planning, Division of Highways, in the preparation of this report.

[1] Illinois Department of Public Works and Buildings, Division of Highways, *Road and Bridge and Other Related Laws of Illinois, 1961* Ed. pp. 152-367. Other sources utilized in prepartion of this section: Illinois Department of Public Works and Buildings, Division of Highways, *Annual Report*, 1952-1960; and Griffenhagen and Associates, *A Highway Improvement Program for Illinois, November*, 1948, 237 pp.

municipalities working under the supervision of the Division and at the expense of the state. Practical administration and supervision of construction, maintenance and repair of the state highway system is performed by the central offices and the ten Bureaus of the Division of Highways together with the offices of the highway districts into which the state has been divided to allow closer supervision.

Other highway systems established by the 1959 Code are the county highway system, the township and district road system, and the municipal street system. The county highway system, formerly known as the state-aid road system, includes rural state-aid highways and their municipal extensions constructed with joint state and county funds and for which the counties have the responsibility for maintenance, and the majority of federal-aid secondary mileage.[2] Construction of most of the road mileage in the county highway system is supervised by the Division of Highways, since either state or federal funds are often involved. The Division cooperates with the County Board of Supervisors or Commissioners which, in the person of the County Supervisor of Highways, has general supervision of all county and road district roads. The county board constructs and maintains all county highways (excepting those maintained by the state) by contract or with its own forces. The county board may contract with municipalities for maintenance of municipal extensions of county highways, and in certain instances can construct or repair bridges, grade separations, and other highway structures across or along any highway in the county, using either county funds or apportioning the cost with other authorities. Highways in the county highway system may be changed, added to, or deleted by the county board subject to the approval of the Division of Highways, and unless abandoned, such alterations increase or decrease the state, township and district, or municipal systems.

The township and district road system includes all rural roads which are neither a part of the state, county, or municipal systems, nor under the jurisdiction of any department or agency of the state other than the Department of Public Works and Buildings or any municipal corporation other than a municipality, and for which responsibility for maintenance and repair rests with the road district. Formerly known as the local rural road system, the township and district system in Illinois may be under the administrative jurisdiction of any one of five government units: townships, consolidated township road districts, road districts, county unit road districts, or road districts comprising municipalities of less than 15,000 persons in counties not having township organization. Responsibility for the administration of the township and district system rests with elected highway commissioners in road districts, townships and consolidated township road

[2] Counties are responsible for maintenance of state-aid highways with the exception of mileage maintained by the state. Mileage maintained by the state includes approximately 2,200 miles placed in the state highway system; a small amount of mileage for which the State, prior to 1929, had agreed to provide 50 percent of the maintenance expense; and county highways improved with portland cement concrete or bituminous concrete on a rigid base.

districts; the county superintendent of highways in county unit road districts; and the corporate authorities of municipalities organized as road districts. Mileage in the township and district road system may be added to, altered or reduced as new roads are laid out or vacated by petition, as roads in subdivisions are accepted, or by mandate of the Division of Highways in the course of construction, maintenance or operation of a State highway.

The fourth system of highways established by the 1959 Code is the municipal street system, which includes streets that are not a part of the state or county highway systems; roads outside the corporate limits of municipalities over which the municipality has jurisdiction; and district roads on the boundary of the municipality for which the responsibility for construction and maintenance is shared with a township or road district or which has had full responsibility placed upon the municipality by contract. The corporate authorities have general supervision over the construction and maintenance of all streets within the corporate boundaries of the municipality. However, the county board may construct and maintain a street with county funds in order to connect or to complete a county highway within the corporate limits of the municipality subject to the approval of the municipality, and the Division of Highways may locate and extend state highways into or through a municipality.

In addition to administering the construction, maintenance and operation of highways in the state highway system, the Division of Highways also supervises construction and maintenance of all highways, roads and streets on which state revenues or federal funds are expended. Consequently, the Division has general supervision over all highways, roads and streets constructed with motor fuel tax revenue in counties, road districts and municipalities, including state-aid highways in the county systems, secondary and feeder roads in townships and road districts, and arterial streets in the municipal system. Construction using federal-aid secondary funds and federal-aid urban funds for extensions of secondary roads into urban areas also comes under the supervision of the Division, as well as construction of forest roads, defense access roads, and railroad grade separations and other structures which involve federal funds. Facilities constructed entirely with local revenue may be improved by the local highway authority without Division supervision, unless it is requested.

The mileage of Illinois highways in the administrative highway systems is shown in Table 1 for the years, 1952, 1955 and 1960. Total highway mileage in Illinois and mileage by systems have been relatively stable during the past ten years.[3] Total highway mileage increased only 683 miles or one-half of one percent between 1952 and 1960. The increase in total mileage has occurred entirely on highways located in urban areas; total rural

[3] Mileages of highways in the four highway systems are altered when new roads are constructed, as corporate limits change, when rural subdivisions are opened, when roads are abandoned, or when mileage is transferred from the jurisdiction of one authority to another.

mileage has remained essentially constant. Mileage in each administrative system, with the exception of the state primary system, has either declined or remained stable. Total state primary mileage increased 1,198 miles, which includes 193 miles of toll roads constructed in recent years. Municipal extensions of primary highways increased by 25 percent of 1952 mileage and rural primary highways only 7 percent.

TABLE 1

Mileage of Illinois Highways by Administrative Systems As of December 31, 1952, 1955 and 1960

	1952	1955	1960¶
State Primary System, Total	12,221	12,344	13,419
Rural*	10,433	10,477	11,163
Municipal Extensions	1,788	1,867	2,256
County Highway System, Total†	19,967	19,991	19,982
Rural‡	18,347	18,328	18,009
Municipal Extensions	1,620	1,663	1,973
Local Rural Roads, Total§	73,689	73,641	73,292
Local City Streets, Total	16,790	17,221	16,657
Total Rural and Municipal Mileage	122,667	123,197	123,350
Total Rural Mileage	102,469	102,446	102,464
Total Municipal Mileage	20,198	20,751	20,886

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics*, 1952, 1955, 1960, Table M-1.
*Includes toll roads: 193 miles in 1960.
†State-aid System prior to 1959.
‡Net of mileage coincident with state primary highways.
§Township and road district system after 1959.
¶With the exception of the County Highway System, mileage figures do not reflect changes made by 1959 Code.

State Highway Revenues

State highway revenues include the motor fuel tax, motor vehicle registration fees, one-third of the operators' license fees, chauffeurs' license fees, federal aid, allocations from the General Revenue Fund, revenue from bond issues, refunds from counties for federal-aid secondary construction, refunds from municipalities, fines, penalties, and miscellaneous sources.[4] All state highway revenues are placed in the State Road Fund, except allotments of motor fuel tax made to counties, road districts and municipalities after deduction of refunds to non-highway users and expenses of collection and administration of the Motor Fuel Tax Law, and a flat $50,000 a month, which is placed in the Grade Crossing Protection Fund. Revenues in the Road Fund are at the disposal of the Division of Highways for construction, maintenance and operation of the state highway system,

[4] For further discussion of highway revenues, see Robert W. Harbeson, "Highway User Charges," in this report.

for transfers and advances to local highway authorities, and to pay administrative costs of the Division of Highways. In addition, appropriations are made from registration fee revenue in the Road Fund for highway-related services provided by other State Departments. The portion of the motor fuel tax revenue allotted to local highway authorities is credited to their accounts in the Motor Fuel Tax Fund from which it is disbursed by the Division of Highways as expended.

Total receipts for highway purposes collected annually 1952-1961 by the state government of Illinois are given in Table 2. Gross total receipts for highway purposes have increased steadily by about $30 million a year on the average from the $169.8 million collected in 1952 to a high of $438.5 million in 1960. Total receipts in 1961 were less than 1960 revenue, the decrease caused by a $50 million reduction in federal aid.

The most important source of state highway revenue prior to 1958 was the motor fuel tax, which averaged 51 percent of total gross receipts in each year, 1952-1957. Registration fees averaged 33 percent annually prior to 1958; federal aid, 14 percent; allocations of general revenue less than 1.0 percent; and other miscellaneous receipts, 3.0 percent. The relative proportions of gross total state highway revenues have been altered since 1957. From 1958 to 1961, federal aid has averaged 38 percent of total receipts in each year as outlays for the Interstate System increased; motor fuel tax revenue fell to an average of 36 percent of total receipts over this period; registration fees decreased to 25 percent; and miscellaneous receipts to 2.0 percent.

Receipts from the federal government for highway purposes depend upon appropriations, the solvency of the Federal Highway Trust Fund and the time of completion of highways constructed in whole or in part with federal funds. Greater variability exists in the amounts of federal-aid revenues received annually than in revenues from other sources and, until proposed completion of the Interstate System in 1972, larger fluctuations can be expected in total gross highway revenues than has occurred in the past.

Disbursements from State Highway Revenues

Disbursements for highways and highway-related purposes at the state level have more than doubled during the past ten years when measured either in current or 1961 dollars. Total disbursements reached a peak in 1960, when increased spending for construction of the Interstate System contributed to the $419.2 million spent for highway purposes in that year. The large increase in expenditures in 1958 and the subsequent decline in 1961 are primarily the result of fluctuating outlays for construction on the Interstate System.

Real growth in disbursements at the state level is indicated by the increases in constant dollar outlay per vehicle registered, per person, and

TABLE 2

Receipts for Highway Purposes, State of Illinois, 1952-1961
(In millions of current dollars)

Calendar Year	Gross Total Receipts	Motor Fuel Tax Revenue†		Motor Registration Fees‡		Federal Aid		Miscellaneous Receipts§		Allocations of General Revenue	
	Amount	Amount	% of Gross	Amount	% of Gross	Amount	% of Gross	Amount	% of Gross	Amount	% of Gross
1952	$169.8	$ 86.4	51.0	$ 52.3	31.0	$ 26.9	16.0	$3.9	2.0	$0.3	*
1953	215.3	112.5	52.0	69.6	32.0	25.8	12.0	7.1	3.0	0.3	*
1954	218.2	113.9	52.0	71.9	33.0	27.0	12.0	5.1	2.0	0.3	*
1955	241.6	124.6	52.0	74.9	31.0	35.1	15.0	6.7	3.0	0.3	*
1956	253.1	127.2	50.0	86.1	34.0	32.4	13.0	7.1	3.0	0.3	*
1957	261.9	131.1	50.0	89.5	34.0	32.9	13.0	8.2	3.0	0.2	*
1958	346.1	135.9	39.0	95.6	28.0	107.1	31.0	7.5	2.0	0.0	0.0
1959	428.1	140.8	33.0	94.7	22.0	183.1	43.0	9.5	2.0	0.0	0.0
1960	438.5	144.2	33.0	98.7	23.0	186.9	43.0	8.7	2.0	0.0	0.0
1961	390.9	147.8	38.0	100.7	26.0	133.3	34.0	9.1	2.0	0.0	0.0

SOURCE: Illinois Department of Public Works and Buildings, Division of Highways, *Annual Reports*, 1952-1960, and materials furnished by the Division of Highways.

*Less than one percent.

†After refunds to non-highway users, and the 2 percent distributor's fee.

‡Motor vehicle registration fees and operators' license fees.

§Fines, penalties, refunds from counties and municipalities, trust fund revenues and other collections.

per vehicle mile traveled on Illinois highways over the period, 1952-1961.[5] Once again, large expenditures on the Interstate System caused these indices to increase markedly after 1957. The greatest relative increase occurred in disbursement per person, which doubled by 1960, compared to a 70 percent increase in outlay per vehicle registered and a 90 percent increase in disbursement per vehicle mile. The changes in these indices reflect the increasing density of vehicle ownership which has resulted from the growth of the Illinois economy, rising per capita income, and an increasingly important role for motor transportation as a means of conveyance. In 1952, there was one vehicle registered for every 3.12 persons; by 1960 the ratio was one vehicle for every 2.67 persons.

Highway expenditures from state highway revenue are separated by purpose in Table 4. Disbursements for highway purposes net of principal retirement of highway debt totaled $2,801 million over the ten year period, 1952-1961. The $1,390.9 million expended for construction over the ten year period accounted for greatest share of total disbursements, about 50 percent. Expenditures for other highway purposes in order of magnitude are payments to local governments, which totaled $758.8 million or 27 percent of total disbursements; maintenance, $276.7 million and 10 percent; administration and overhead, $252.6 million and 9 percent; policing, $74.5 million and 3 percent; interest on highway debt, $29.4 and 1 percent; highway revenue collection costs, $15.0 million and about 0.5 percent; and diversions for non-highway purposes, $3.2 million, less than 0.5 percent of total expenditures. The changing relationships of these expenditures as proportions of generally increasing total disbursements in each year from 1952 to 1961 are also shown in Table 4. Construction outlays, in particular, have shifted to a higher proportion of total disbursements in recent years, and administration and overhead outlays to a lesser extent. Outlays for policing and interest on highway debt (with the exception of 1961) have remained essentially constant proportions of increasing total expenditures. On the other hand, payments to local governments and collection costs have not kept pace with the increase in total expenditures.[6]

[5] Vehicle miles of travel on Illinois highways is an imperfect indicator of the intensity of use of the highway system, as shown by the character of traffic in the rural primary system. Since 1952 the relationship between private and commercial traffic has remained relatively constant, with commercial traffic accounting for about 18 percent of total traffic on the average and private passenger cars, 82 percent. The major change has been the shift in types of commercial vehicles. The trend has been to larger tractor-truck semitrailers capable of carrying significantly larger loads. The percentage of 3-axle semitrailers declined from 63 percent of total semitrailers in 1949 to 17.6 percent in 1961. Four-axle trailers increased from 35 to 56 percent from 1949 to 1959 and then declined to 50.9 percent in 1961. The percentage of 5-axle trailers, however, increased from less than 1.0 percent in 1949 to 31.4 percent of total tractor-truck semitrailers in 1961. Average loaded weights, which have changed little since 1949, are 31,000 lbs. for the 3-axle; 45,500 lbs. for the 4-axle; and 56,000 lbs. for the 5-axle semitrailers. These trends indicate an increasing intensity of use of Illinois highways above that indicated by increases in total vehicle miles traveled. See: Illinois Department of Public Works and Buildings, Division of Highways, Bureau of Research and Planning, *Traffic Characteristics on Illinois Highways, 1961*, pp. VIII-IX, 107-115.

[6] For definitions of these expenditure categories, see the footnotes to Table 4. Interest on debt, a construction expense, and policing and revenue collection costs, which are administrative and overhead outlays, have been separated for further examination.

TABLE 3

Total Disbursements from State Highway Revenues, 1952-1961*

Calendar Year	Total Disbursements (Current Dollars)		Total Disbursements† (1961 Dollars)		Disbursement Per Vehicle Registered‡ (1961 Dollars)		Disbursement Per Person (1961 Dollars)		Disbursement Per Thousand Vehicle-Miles (1961 Dollars)	
	Amount (millions)	Index (1952=100)	Amount (millions)	Index (1952=100)	Amount Per Vehicle	Index (1952=100)	Amount Per Person	Index (1952=100)	Amount Per 1,000 Vehicle Miles	Index (1952=100)
1952	...$163.3	100.0	$183.9	100.0	$ 65	100.0	$21	100.0	$ 6.21	100.0
1953	... 186.3	114.0	208.2	113.0	70	108.0	23	110.0	6.89	115.0
1954	... 218.5	134.0	243.3	132.0	79	122.0	27	129.0	8.03	133.0
1955	... 221.7	136.0	247.4	135.0	76	117.0	27	129.0	7.56	127.0
1956	... 221.6	136.0	243.8	133.0	72	111.0	26	124.0	7.39	123.0
1957	... 254.5	156.0	270.7	147.0	77	118.0	28	133.0	7.94	132.0
1958	... 356.1	218.0	368.6	200.0	103	158.0	37	176.0	10.56	177.0
1959	... 385.6	236.0	395.5	215.0	107	165.0	40	190.0	11.08	185.0
1960	... 419.2	257.0	423.4	230.0	112	172.0	42	200.0	11.57	193.0
1961	... 374.2	229.0	374.2	203.0	97	149.0	36	171.0	9.95	167.0

SOURCE: Illinois Department of Public Works and Buildings, Division of Highways, *Annual Report*, 1952-1960, and material furnished by the Division of Highways.

*Disbursements include expenditures for construction, maintenance and administration of the state highway system, interest on debt incurred for the state highway system, policing, payments to local governments (including MFT allotments), collection costs, payments to other State Departments, and diversions. Refunds of MFT revenue and principal payments on bond isues are not included to avoid overstating expenditures.

†National consumers price index was used to obtain constant dollars.

‡Passenger cars, trucks and buses.

TABLE 4

Disbursements for Highway Purposes, State of Illinois, 1952-1961
(In millions of current dollars)

Calendar Year	Total Disbursements†	Payments to Local Governments‡		Construction§		Maintenance¶		Administration and Overhead•		Interest on Debt**		Policing††		Collection Costs‡‡		Diversions§§	
	Amount	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
1952	$ 163.3	$ 47.0	29.0	$ 72.7	44.0	$ 22.8	14.0	$ 12.0	7.0	$ 2.0	1.0	$ 4.6	3.0	$ 1.1	0.7	$1.1¶¶	1.0
1953	186.3	60.4	32.0	83.8	45.0	20.5	11.0	14.0	8.0	1.7	1.0	4.5	2.0	1.3	0.7	*	*
1954	218.5	69.1	32.0	98.9	45.0	24.9	11.0	17.4	8.0	1.6	0.7	4.3	2.0	1.3	0.6	1.1¶¶	0.5
1955	221.7	73.0	33.0	98.3	44.0	24.5	11.0	17.5	8.0	1.3	0.6	4.8	2.0	1.4	0.6	1.0¶¶	0.5
1956	221.6	69.0	31.0	96.4	44.0	25.9	12.0	20.2	9.0	3.1	1.0	5.5	3.0	1.4	0.6	0.0	—
1957	254.5	87.4	34.0	102.9	40.0	27.4	11.0	26.6	10.0	1.7	0.7	7.1	3.0	1.5	0.6	0.0	—
1958	356.1	93.8	26.0	188.1	53.0	28.8	8.0	32.6	9.0	1.7	0.5	9.5	3.0	1.6	*	0.0	—
1959	385.6	78.2	20.0	224.7	58.0	30.4	8.0	37.2	10.0	2.8	0.7	10.6	3.0	1.6	*	0.0	—
1960	419.2	90.1	22.0	237.9	57.0	36.4	9.0	37.6	9.0	4.0	1.0	11.5	3.0	1.8	*	0.0	—
1961	374.2	90.8	25.0	187.2	50.0	35.1	9.0	37.5	10.0	9.5	3.0	12.1	3.0	2.0	0.5	0.0	—
Total	$2,801.0	$758.8	27.0	$1,390.9	50.0	$276.6	10.0	$252.6	9.0	$29.4	1.0	$74.5	3.0	$15.0	0.5	$3.2	*

SOURCE: Illinois Department of Public Works and Buildings, Division of Highways, *Annual Report*, 1952-1960, and materials furnished by the Illinois Division of Highways.

*Less than .5 percent.

†Net of payment of principal on bonded debt and refunds of motor fuel tax collections. Transactions of State Garage Revolving Fund are not included. Rounding may cause discrepancy in totals.

‡MFT allotments to other government units. Advances to other government units not included.

§For construction, additions and betterments on highways, buildings and weight stations, including land, and advances to other units. Bond service on Cook County Expressway Bonds is not included. The interest portion of this debt is included in column headed Interest, while the principal payment portion is excluded altogether.

¶For maintenance of state highways, city beltlines, and highway traffic control.

•Costs of the Division of Highways and payments to other State Departments excluding administration expense for MFT law incurred by both Division of Highways and Department of Revenue; administration expense of Motor Vehicle Law and MFT refunds. Includes some non-highway expenditures.

**Includes interest on Cook County Expressway bond issues and $60 million and $100 million bond issues.

††Paid from registration fees. Not all of these disbursements are chargeable to highway purposes, since the police force has other functions than enforcement of traffic laws.

‡‡Administration expense of MFT Law incurred by Division of Highways and Department of Revenue, administration expense of Motor Vehicle Law, excluding refunds of MFT. Cost of collecting registration fees is in Administrative and Overhead column.

§§Diversions in the past have included allotments to the City of Chicago for school purposes; to the State Common School Fund; and debt service on a $20 million and $30 million Relief Bond Issue.

¶¶Debt service on $30 million Relief Bond Issue.

TABLE 5

Total Disbursements for Construction, State of Illinois, 1952-1961

(In millions of current dollars)

Calendar Year	Total Disbursements for Construction†	Expended Directly by State for Construction of Highways	Expended by State for Right-of-way	Expended by State for Construction of Buildings and Land	Federal Funds Reimbursed to Cook County and Chicago‡	Advanced to Cook County for Service of Expressway Bonds	Construction Expenditures to be Reimbursed by Counties and Cities	Grade Crossing Protection Fund
1952	$ 71.4	$ 66.2*	$ *	$0.4	$ 4.7	$ 0.0	$0.1	$0.0
1953	83.5	66.2	7.6	0.2	6.1	0.0	3.4	0.0
1954	99.0	76.7	16.0	0.5	4.7	0.0	1.1	0.0
1955	98.3	68.4	19.6	2.7	5.9	0.0	1.7	0.0
1956	100.4	76.2	12.0	2.1	3.8	4.0	2.3	0.0
1957	105.9	76.9	18.9	2.1	3.0	2.9	2.0	0.1
1958	192.1	132.0	35.2	2.5	3.8	17.2	1.2	0.2
1959	235.5	159.2	33.7	2.1	27.6	10.9	1.5	0.5
1960	252.9	193.1	18.3	0.9	23.9	14.7	1.7	0.3
1961	225.8	177.3*	*	1.4	6.6	38.3	1.9	.0.3

SOURCE: Illinois Department of Public Works and Buildings, Division of Highways, *Annual Report*, 1952-1960.
*Expenditures for right-of-way included in amount disbursed by state for construction.
†Excluding trust fund outlays.
‡For state's share of expressway contracts.

Construction Expenditures

State highway revenues are used for the construction of Interstate, federal-aid primary, federal-aid secondary and state-aid highways; state highways through and around urban areas; expressways in Cook County; highway buildings and land; highways and structures authorized by special appropriations; and additions and betterments that modernize and improve existing routes. Total construction expenditures by the state during 1952-1961 are separated by purpose in Table 5. A suggestive breakdown of recent construction expenditures is provided by analysis of construction contracts awarded by the Division of Highways, Cook County and the City of Chicago, combined with contracts for state-supervised construction performed by the state's own forces. Construction contracts totaled $211.3 million in 1960, of which $101.1 million was awarded for work on the Interstate System; $85.2 million for the primary highway system; and $25.0 million for construction on the secondary highway system. Rehabilitation of the existing system accounted for 40.9 percent of primary highway contracts and 12.7 percent of secondary system contracts.[7]

Construction expenditures per vehicle registered and per vehicle mile traveled during the period 1952-1961 have increased noticeably, especially after 1957. Prior to 1958, total annual construction disbursements fluctuated around an average of about $30 per vehicle registered; after 1957 outlay per vehicle doubled. Construction outlays per vehicle mile traveled prior to 1958 were about $0.003 annually and once again doubled after 1957.

The construction dollar in Illinois has generally maintained the same purchasing power during the past ten years. The trend in the composite highway construction price index compiled by the Illinois Division of Highways indicates that construction prices have been fluctuating around the same level from 1952 to 1961, although the index has increased significantly from the early post-war level. Construction outlays during the past ten years in real terms, therefore, have kept pace with the increased usage of the highway system without inclusion of outlays for the Interstate System and, in recent years, with Interstate expenditures included, have surpassed increased usage measured in vehicle miles of travel.

The important change in Illinois highways over the period, 1952-1961, has not been construction of additional mileage, but rather the improvement of existing routes. As shown in Table 7, the annual mileage constructed, paved and resurfaced by the Division of Highways and by other highway authorities working under state supervision has been substantial.

Highways can be described physically according to the geometric design, materials, and methods used in their construction. Design and structure of highways vary depending upon the function to be performed by the traffic facility and volume and type of traffic served. The improved design

[7] Illinois Department of Public Works and Buildings, Division of Highways, *Annual Report*, 1960, p. 30-46.

and structure of Illinois highways for the period, 1952-1960, reflect past and prospective changes in the volume, speed and character of traffic. Continuous improvement in surfaces and widths of Illinois highways is noticeable over the past ten years. The mileage of rural roads having an earth surface has declined from 14,343 miles in 1952 to 8,661 miles in 1960, a decrease of 35 percent. Practically all of the earth surfaced roads are in the local rural road system, which had 13.5 percent of its total mileage in unsurfaced roads in 1952 and 8.4 percent in 1960. The county highway system had less than 60 miles of earth roads in 1960 and the primary system contained none. The mileage of rural highways with low-type surfaces, including low-type bituminous, gravel or stone, and oiled earth, increased from 76,229 miles in 1952 to 81,099 miles in 1960. The local rural road system accounted for over 97 percent of the total 4,870 mile increase in rural mileage having low-type surfacing; roughly 80 percent of its mileage has such surfaces. Over 85 percent of the county highway system and 3 percent of the primary system had low-type bituminous surfaces during the 1952-1960 period. The total rural mileage of paved highways, which includes portland concrete cement surface, brick, block, and high-type bituminous surfaces, has increased slightly to 12,429 miles from the 12,186 miles in existence in 1952. Approximately 12 percent of the total rural highway mileage has had paved surfaces over the 1952-1960 period. All of the small net addition of paved mileage has been on the primary highway system, which has over 95 percent of its mileage paved. The county highway system had approximately 10 percent of its mileage in paved surfaces during each of the past ten years, and the local rural road system less than 1 percent.

Concommitant with the improvement in surfaces, there has been a constant widening of existing mileage in the primary highway system. The

TABLE 6

Historical Highway Construction Price Trend
(Base Period 1937-1941)

Year	Composite Trend*	Year	Composite Trend*
1946	142	1954	187
1947	153	1955	179
1948	182	1956	195
1949	162	1957	218
1950	158	1958	196
1951	189	1959	198
1952	195	1960	199
1953	192	1961	190

SOURCE: Material furnished by the Illinois Division of Highways.
*A weighted average of indices of prices for grading work, surfacing, and structures, none of which have tended to move from their respective levels during 1952-1961.

TABLE 7

Pavement Mileage Constructed by the State and by the Counties, Cities and Townships Under State Supervision

	State Construction						
Year	Fed.-aid Interstate*	Primary†	Secondary‡	County Construction	City MFT Construction	Township Construction§	Total
1952	. . .	1,441.27	460.47	438.28	200.31	642.70	3,183.03
1953	. . .	872.12	562.19	323.34	230.61	1,666.29	3,654.55
1954	. . .	741.82	343.49	267.73	204.23	1,809.58	3,366.85
1955	. . .	371.86	535.69	331.65	301.34	2,018.60	3,559.14
1956	. . .	560.61	491.05	334.19	258.78	1,646.61	3,291.24
1957	. . .	510.96	524.93	273.17	213.67	1,753.53	3,276.26
1958	. . . 37.37	1,035.49	588.33	238.95	244.26	1,612.23	3,756.63
1959	. . . 40.77	648.20	672.36	346.09	208.17	1,563.98	3,479.57
1960	. . . 95.19	611.55	545.15	291.76	224.96	1,451.23	3,219.84

SOURCE: Illinois Department of Public Works and Buildings, Division of Highways, *Annual Report*, 1960, p. 33.
*Previous to 1958 interstate work is included in column showing primary mileage.
†Includes full-width PCC base and widening of existing PCC pavemen' prior to surfacing with bituminous concrete.
‡Includes surfacing constructed with State and federal funds on state-aid or federal-aid secondary routes, access roads not on state system, and mileage in state parks, state institutions, etc.
§Oiled earth and grading not included. 1960-1953 are mileages actually constructed; 1952 mileage is that approved for construction.

mileage of high-type primary highways having widths of 21 feet or less has declined continuously during the past ten years, decreasing from 7,514 miles or 75 percent of the total 10,163 miles of high-type primary highways in 1952 to 5,974 miles or 54 percent of the 10,970 existing miles in 1960. On the other hand, the mileage of high-type primary highways having widths of 22 to 26 feet and 27 feet and over has been increasing. The 22-26 foot category has increased from 21 percent of the 1952 system to 33 percent in 1960; highways of 27 feet width and over increased from 4.6 percent to 8.3 percent of the primary system. Municipal extensions of the primary system have followed the same general trends except that the greater percentage of municipal extensions are in the wider width categories.

Maintenance Expenditures

Highway maintenance is divided into two separate phases, maintenance and operation. The purely maintenance phase consists of repairing surfaces and shoulders, cleaning, painting and repairing highway structures, etc. The operation phase of maintenance includes the application of traffic markings, erection and repair of signs, mowing roadsides, and removal of snow and ice. Maintenance expenditures are made to keep the highway in its original condition. Operation expenditures involve maintenance while at the same time increasing the efficiency of the highway. Maintenance expenditures are dependent upon the type and age of the facility and the type and volume of traffic. Operation expenditures are relatively independent of the type and age of the highway, but are influenced by traffic and weather conditions.

Maintenance and operation costs for expressways and all other highways maintained by the Division of Highways are given in Table 8 for 1952-1961. Maintenance costs per mile of expressway maintained averaged $4,370 over the period, 1957-1960, an increase of more than four and one-half times the 1953-1956 average per mile cost of $905. Operation costs per mile on expressways have also increased from an average of $13,874 per mile maintained during 1953-1956 to $18,285 per mile during 1957-1960, an increase of about 50 percent. Interpretation of these cost per mile figures as indications of the level or trend of future maintenance and operation costs of expressway facilities is hampered by the relatively few miles and newness of the existing expressway system. More reliance may be placed on the trend and level of maintenance and operation costs of all other highways under the jurisdiction of the state. These costs have increased during the past ten years, although to a lessor extent than expressway maintenance and operation costs.

The average maintenance cost per mile of highway maintained on all other highways was just over $800 for 1952-1956; during the period, 1957-1960, maintenance costs have increased to an average of $880 per mile maintained. Operation costs on all other highways rose from a per mile main-

TABLE 8

Maintenance and Operation Costs, State of Illinois, 1952-1961*

Year	Expressways					Rural, Urban and Beltline Routes					Total All Routes				
	Mileage Main-tained	Maintenance		Operation		Mileage Main-tained	Maintenance		Operation		Mileage Main-tained	Maintenance		Operation	
		Cost (000)	Per Mile	Cost (000)	Per Mile		Cost (000)	Per Mile	Cost (000)	Per Mile		Cost (000)	Per Mile	Cost (000)	Per Mile
1952	...n.a.	$ n.a.	$ n.a.	$ n.a.	$ n.a.	14,256	$11,250	$789	$ 9,245	$ 649	14,256	$11,250	$789	$ 9,245	$ 649
1953	...28	26	954	199	7,220	14,233	11,026	775	8,511	598	14,261	11,052	775	8,710	611
1954	...28	13	474	394	14,256	14,267	11,995	841	10,968	769	14,295	12,008	840	11,362	795
1955	...28	27	983	442	15,977	14,297	11,578	810	11,285	789	14,325	11,605	810	11,727	819
1956	...31	37	1,208	553	18,044	14,344	11,929	832	12,328	859	14,375	11,966	832	12,881	897
1957	...44	203	4,643	580	13,296	14,414	11,985	831	12,702	881	14,458	12,188	844	13,282	919
1958	...52	239	4,591	754	14,476	14,400	13,353	927	13,638	947	14,452	13,592	940	14,392	996
1959	...53	204	3,881	1,014	19,275	14,434	12,087	837	16,016	1,110	14,487	12,291	848	17,030	1,176
1960	...53	231	4,374	1,378	26,091	14,553	13,498	928	18,977	1,304	14,606	13,729	940	20,355	1,394

SOURCE: Illinois Department of Public Works and Buildings, Division of Highways, *Annual Report*, 1952-1960.
*All costs include administration and engineering expense of district offices and a pro rata share of the central office expense.

tained average of $730 to $1,060 for this period, an increase of almost one and one-half times. Total maintenance and operation costs for the entire system maintained by the Division of Highways reflect the increased costs per mile maintained of both expressways and all other highways. Total maintenance costs per mile increased from an average of $810 during 1953-1956 to $890 for 1957-1960, while average total operation costs per mile rose from $780 to $1,121 between the two periods.

The trend of maintenance and operation expenditures in relation to increased intensity of use of highways maintained by the Division of Highways indicates that these outlays have exceeded the increased travel. The total costs of maintenance and operation per mile of highway maintained per million vehicle miles of travel have increased from $0.097 in 1952 to $0.111 in 1960, with a relatively large jump between 1957 and 1958. The increase in total per highway mile costs of maintenance and operation per million vehicle miles of travel is accounted for entirely by increased operation costs, which grew from $0.044 in 1952 to $0.064 in 1960 while maintenance costs remained at approximately $0.051 per mile maintained per million vehicle miles.[8] A similar trend is indicated by a national index of cost trends for highway maintenance and operation. The national index of highway maintenance and operations costs has increased continuously from 1952 to 1960. The maintenance and operation dollar bought 30 percent less in 1960 than in 1952.[9]

Administrative and Overhead Expenditures

Overhead costs of the Division of Highways include disbursements for administration, engineering, testing, and equipment; expenses of the statewide highway planning survey; and administration of the safety responsibility law. In addition, appropriations from the Road Fund are paid to other State Departments for highway purposes, including operation of the State Automobile Department, Operators' License Department and Safety Responsibility Department; administration of the Motor Fuel Tax Law and Motor Vehicle Law; compensation for damages to private property, employee compensation and treatment for injuries; architectural services; construction of the Cook County Land and Office Building; and policing of highways. The total of these expenses have been divided into overhead and administrative outlays for services directly attributable to the Division of Highways and outlays to other State Departments for various services listed above with the exceptions of disbursements for policing and motor fuel tax revenue collection costs, which are examined separately.

Administrative and overhead costs, net of outlays for collection of revenues and policing of highways, have increased continuously from $16.6

[8] One-half of the annual total vehicle miles of travel in Illinois in each year, 1952-1961, has been estimated by the Division of Highways to have occurred on the primary highway system, for which the Division has maintenance responsibilty.

[9] The natonal index of cost trends for highway maintenance and operations is a weighted index based on the costs of maintaining and operating the existing highway systems in the various states. See: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics*, 1960, Table PT-5.

million in 1952 to $49.6 million in 1961, an average increase of almost 20 percent a year. The relative portions of total net administrative and overhead costs attributable to the Division of Highways and to other State Departments has shifted slightly in the past ten years. Prior to 1957, the ad-Administration and overhead costs incurred by the Division of Highways was slightly less than 50 percent of the total of these costs. Administration and overhead costs of other State Departments averaged 54 percent over the same period. Subsequent to 1956 the proportions have been reversed. Administration and overhead costs incurred by the Division of Highways are responsive to the amount of construction and maintenance performed on highways under state control and therefore can be expected to increase as such work expands. Many of the administration and overhead costs incurred by other state departments are relatively inelastic with respect to the amount of construction and maintenance performed and vary instead with revenue or legislative appropriations for "highway-related uses" such as the Cook County Land and Office Building. The greater portion of future administration and overhead costs should continue to accrue to the Division of Highways.

Appropriations for policing of Illinois highways are made from the Road Fund and paid to the Department of Public Safety.[10] In Table 4, it was shown that disbursements for policing have been consistently 2 or 3 percent of total annual net disbursements for highway purposes. Total expenditures for policing were $4.6 million in 1952 and $12.1 million in 1961, an increase of over 160 percent. Outlays for policing tend to increase in discrete jumps as the force and salaries are increased from time to time. Policing costs per million vehicle miles of travel on all Illinois highways and on a per capita basis have doubled since 1952. Increasing traffic, expenditure for modern law enforcement equipment, an enlarging population and rising salaries insure continued increases in disbursements for policing.

Total motor fuel tax revenue collection costs have almost doubled in the past ten years, increasing from approximately $1.0 million in 1952 to $2.0 million in 1961. These costs are primarily responsive to the amount of revenue collected from the motor fuel tax. As a percentage of gross motor fuel tax, collection and administration costs have totaled annually about one percent.

Payments to Local Governments

Payments to local governments by the Division of Highways include disbursements from the Motor Fuel Tax Fund allotments of counties, road districts, and municipalities for construction and maintenance expenses incurred by these government units, as well as advances from the Road Fund to facilitate construction of state highways. Advances for construction of state highways are included in state construction expenditures shown in

---

[10] Although the state police force has other functions than the enforcement of traffic laws, no division of expenditure for policing is made on this basis.

Table 5. Payments to local governments net of these advances have increased with some irregularity almost 100 percent from $47.0 million in 1952 to $90.8 million in 1961. These funds are available to government authorities for lawful uses and are disbursed by the Division of Highways as expended.

Interest Payments on Highway Debt

Debt financing has been little used as a source of revenue for construction of highways in the state highway system. Bond issues for $60,000,000 and $100,000,000 were issued in 1918 and 1923 to construct certain major highways now known as the State Bond Issue system. The $60,000,000 issue was retired by 1944. There was still $54,044,000 of the 1923 issue outstanding at January 1, 1952; all but $75,000 of which was retired by December 31, 1959. Since 1959, Cook County has been given the privilege of issuing bonds for expressway construction in the amount of $245,000,000 without referendum. Seven series of these bonds, a total of $175,000,000, had been issued by December 31, 1960 at interest rates varying from 2 3/4 to 4 percent. The proceeds from the Expressway bonds are used to construct state highways in Cook County and debt service has been paid from state highway revenue.

TABLE 9

Administrative and Overhead Highway Costs, State of Illinois, 1952-1961
(In millions of current dollars)

Calendar Year	Total Net Administrative and Overhead Costs*	Costs of Division of Highways		Costs of Other State Departments	
		Amount	% of Total	Amount	% of Total
1952	$16.6	$ 7.6	46.0	$ 9.0	54.0
1953	18.5	8.8	48.0	9.7	52.0
1954	21.7	9.6	44.0	12.1	56.0
1955	22.3	10.5	47.0	11.8	53.0
1956	25.7	12.2	47.0	13.5	53.0
1957	33.7	18.0	53.0	15.7	47.0
1958	42.1	21.6	51.0	20.5	49.0
1959	47.8	25.1	53.0	22.7	47.0
1960	49.1	25.5	52.0	23.6	48.0
1961	49.6	26.0	52.0	23.6	48.0

SOURCE: Illinois Department of Public Works and Buildings, Division of Highways, *Annual Reports*, 1952-1960.
*Net of outlays for policing and motor fuel tax revenue collections costs.

Annual interest payments on the $100,000,000 State Bond Issue and the Expressway bonds averaged almost $3.0 million from 1952 to 1961. The annual interest payments and principal retirement on these debt issues

from 1952 to 1961 and total disbursements for highway purposes adjusted for principal repayments are given in Table 10.[11]

Diversions for Non-Highway Purposes

Diversions of highway revenues shown in Table 4 were less than 0.5 percent of total disbursements for highway purposes during the past ten years. This small amount of diversion was to retire a $30,000,000 Relief Bond Issue still outstanding. More recently, however, highway revenues have been used for "near-diversion" purposes. A total of $3,950,000 has been expended from Road Fund revenues for the construction and equipment of three buildings in Cook County to be used by the Secretary of State for administration of laws relating to motor vehicles. Also in 1961, the General Assembly authorized transfer of an amount not to exceed $34,000,000 from the Motor Fuel Tax Fund to the General Revenue Fund if necessary to enable normal transactions to be made in the latter fund. These funds are to be taken from the motor fuel tax allotments of municipalities (up to $19,000,000 counties (up to $10.000,000); and townships and road districts (up to $5,000,000). Repayment is to be made from the General Revenue Fund on or before June 30, 1963. In October, 1961, $17,000,000 was transferred to the General Revenue Fund. These uses of highway revenues are not labeled diversions, the first because it was considered a highway-related purpose, and the latter because the transfer of motor fuel tax is temporary.

Wholesale diversion of highway revenues by states in the early 1930's resulted in passage of the Hayden-Cartwright bill in 1934. The antidiversion provision of this bill has been interpreted by the U.S. Bureau of Public Roads to mean that a state can divert the percentage amount of highway-user taxes provided by law for highway purposes on June 18, 1934, and all of the revenue brought in by taxes levied after June 18, 1934 and/or by increases in tax rates after that date, without incurring the penalty of having federal aid to the state in any fiscal year reduced up to one-third.[12] Diversion was limited, in effect, to the extent permitted by the state in 1934. As the Hayden-Cartwright bill has been interpreted, Illinois can presently divert about 50 percent of highway-user revenue without penalty.[13]

---

[11] Principal retirement was excluded from total disbursements in Table 4 to avoid overstating the annual amounts disbursed for highway purposes since revenues from bond issues appear elsewhere as expenditures.

[12] Sherwood K. Booth, "Protection of Road User Revenues Under Section 12 of the Hayden-Cartwright Act," an address of the Deputy General Counsel, Bureau of Public Roads, to the Committee on Highway Taxation and Diversion of the Eighth Highway Transportation Congress, Washington, D.C., May 10, 1960.

[13] The Illinois law in 1934 provided for a 3-cent gasoline tax and a schedule of registration fees which together brought in about $47.4 million in revenue available for highway purposes during 1934. Illinois diverted a total of $8.6 million, approximately 18 percent, of this highway-user revenue. Diversions were for $20,000,000 and $30,000,000 Relief Bond Issues, and for educational purposes in the State and the City of Chicago. Illinois may divert up to 78 percent of highway-user revenues collected today under the 1934 tax rates. In addition, increases in highway-user revenues due to tax levies and rate increases imposed after 1934 may be completely diverted without penalty. Motor fuel tax is currently 5 cents a gallon and there were substantial increases in motor vehicle registration fees in 1952. The total revenue brought in by the additional 2 cents per gallon fuel tax and the increase in registration fees, *plus* about 18 percent of current highway user revenues brought in under the 1934 tax rates, can be diverted without penalty. For further discussion, see: Case M. Sprenkle and William Habacivch, "Earmarking," in this report.

There are several relatively fixed claims against state highway revenues, such as matching funds for Interstate and other federal-aid systems, administrative and overhead expenses incurred by the Division of Highways, bond service on highway debt, and disbursements to other State Departments for the various highway-related services such as policing, opera-

TABLE 10

Debt Services on Highway Bonds and Total Disbursements for Highway Purposes Inclusive of Payments of Principal on Highway Bonds, 1952-1961

(In millions of current dollars)

Year	Debt Service on $100,000,000 Issue		Debt Service on Outstanding Expressway Bonds		Total Disbursements for Highway Purposes	
	Principal	Interest	Principal	Interest	Without Principal*	With Principal
1952	....$5.9	$2.0	$	$	$163.3	$169.2
1953	.... 6.5	1.7			186.3	192.8
1954	.... 6.5	1.6			218.5	225.0
1955	.... 6.5	1.3			221.7	228.2
1956	.... 6.5	1.0	2.0	2.0	221.6	230.1
1957	.... 7.5	0.8	2.0	0.9	254.4	264.0
1958	.... 7.6	0.4	2.5	1.3	356.1	366.2
1959	.... 7.0	0.1	8.3	3.7	385.6	400.9
1960	....		10.8	4.0	419.2	430.0
1961	....		28.8	9.5	374.2	403.0

SOURCE: Illinois Department of Public Works and Buildings, Division of Highways, *Annual Report*, 1952-1960, and material furnished by the Division of Highways.
*Table 4.

tion of the State Automobile Department, etc. As a practical matter, diversion could not occur to an extent greater than the total of these expenses.[14] Highway-user revenues totaled $241 million in 1960 after refunds and collection costs. Of this $241 million, roughly 50 percent or $120.5 million could be diverted without invoking the Hayden-Cartwright antidiversion provision. About $130 million was needed in 1960 to meet the fixed costs listed above, leaving $120 million of state highway revenues (both user and nonuser) available to state and local highway authorities for maintenance and construction. All of this $120 million could be diverted without penalty. No distinction, however, was made in this calculation between Road Fund revenue and Motor Fuel Tax Fund revenue. The fixed costs mentioned above are met from the Road Fund, which received total revenues of $157 million in 1960 from which the $130 million above was expended to match

[14] In addition to fixed expenses, some minimal level of expenditure would be necessary for maintenance of the state highway system. No allowance is made in these calculations for such expenditure.

federal aid, for administration and overhead expenses, bond service, and payments to other State Departments. If diversion of highway revenues is necessary, the funds should be taken (as they have been) from the county, township or district, and municipal share of motor fuel tax.

Projected Expenditures for Illinois Highways, Fiscal 1962-71

Projections of highway expenditures are typically done by performing a "needs study" or by some approach which forecasts revenues available for financing highways. The needs study is primarily an engineering survey of present and prospective deficiencies in the highway system and the costs of their elimination. Needs studies are made by canvassing the physical characteristics of the highway system and comparing the existing design and condition of the system with geometric design standards and construction adequate to handle the volume and character of traffic expected at some future date. By matching the present design and condition of the highways with these design standards, the extent of the deficiencies and their cost of correction can be calculated. One or more "catch-up" time periods are usually assumed during which the deficiencies are to be eliminated. The annual expenditures needed to correct the deficiencies over the catch-up period, plus the costs of meeting needs arising during the period, are then compared with the flow of available revenues to determine the necessity, if any, for deficit financing. Needs studies have properly been designated as one of the functions of the Illinois Division of Highways, which is currently engaged in a comprehensive survey of Illinois highway deficiencies that has been tentatively scheduled for completion early in 1963.

The projections of expenditures in this study are based on estimates of future highway revenues. Three levels of highway revenues are projected by utilizing the personal income projections developed by Ferber and Ford.[15] The three levels of highway revenue are labeled High, Medium, and Low, and represent a range of likely future revenue-expenditures based upon different growth rates of the national and Illinois economy.

The technique for projection of motor fuel tax revenue and revenues from registration fees for the fiscal years, 1962-1971, involves determining the relationship of motor fuel tax revenue and registration fees with Illinois real personal income during the period fiscal 1952 through fiscal 1961 by the use of simple linear regression analysis and applying the relationship thus discovered to estimated personal income for fiscal years 1962-1971. Linear regression analysis gives an estimate of the average change to be expected in a dependent variable, such as motor fuel tax revenue or registration fees, given a change of a certain amount in an independent variable, in this case, real personal income. The assumption when using regression analysis is that the economic factors operating in the period in which the

[15] For development of these personal income estimates, see Robert Ferber and Neil Ford, "The Projected Economic Growth of Illinois to 1971," in this report.

relationship between the dependent and independent variable was determined will continue to act with the same force and in the same direction during the period for which the projections are made, and that institutional factors, such as the state revenue laws, remain unchanged.

Federal aid available for expenditure by the Division of Highways is forecast by estimating Illinois' share of total projected federal aid available to the states during the 1962-1971 fiscal years. Projections of total federal aid for the states have been made by the U.S. Bureau of Public Roads.[16] Revenues from other sources are estimated on the basis of their past relationship to total revenues.

TABLE 11

Projections of Motor Fuel Tax Revenue Available for Highway Purposes by Bienniums, 1961-1963 through 1969-1971*
(In millions of dollars)

Biennium	Level of Projection		
	High	Medium	Low
1961-1963	$300.2	$299.0	$298.3
1963-1965	321.0	317.9	315.5
1965-1967	346.2	338.7	334.0
1967-1969	372.1	359.8	351.7
1969-1971	399.5	381.3	370.3

*Gross total cash motor fuel tax revenue less refunds. Refunds are expected to be 10 percent of annual gross motor fuel tax revenue.

Projection of Motor Fuel Tax Revenue

The range of motor fuel tax revenue estimated to be available for highway purposes in the next ten fiscal years is given by biennium in Table 11.[17] Motor fuel tax is allotted to the state (35 percent); counties (23 percent); townships and road districts (10 percent); and municipalities (32 percent); as well as a flat $600,000 allotment to the Grade Crossing Protection Fund. Total motor fuel tax available for allotment is apportioned among these highway authorities in Table 12.

[16] *U. S. Code, 1961.* Vol. 2: *Legislative History.* Tables 7 and 8, p. 1821.

[17] Note on methodology: The estimating equation is Yc equals a minus bX, where Yc is gross motor fuel tax revenue; (a) is the constant, $45,130,000; (b) is the regressive coefficient, .0042; and (X) is Illinois personal income in a given fiscal year. The coefficient of correlation, (r) is a very high .9594. The standard error of the estimate is $4,800,000. The range within which the estimate of cash motor fuel tax revenue can be expected to fall ninety-five times out of one-hundred in any fiscal year, 1962-1971, is the estimate for that year plus and minus $9,500,000. The inference is that estimates derived by use of simple linear regression analysis are estimates of the average relation between Y and X. Other factors affect this relation and, in general, the greater the influence of these factors, the larger the standard error of the estimate and the broader the range within which the projected cash motor fuel tax revenue, or Y, can be expected to fall at a given confidence level. Yc plus or minus $9,500,000 is not an exceptionally large range considering that Yc is over $150,000,000. In performing the regression analysis, data were converted to 1961 dollars and centered on January 1 of each year. Motor fuel tax revenue was adjusted for rate changes.

TABLE 12

Projections of Gross Total Cash Motor Fuel Tax Revenue, Net Cash Motor Fuel Tax Revenue Available for Allotment, and Allotments by Highway Systems
(In millions of dollars)

Biennium	Gross Total Cash MFT Revenue			Net MFT For Allotment*			Allotment for State Highway System		
	High	Medium	Low	High	Medium	Low	High	Medium	Low
1961-1963	$333.5	$332.2	$331.5	$295.2	$294.1	$293.5	$103.3	$103.0	$102.8
1963-1965	356.7	353.2	350.6	315.9	312.8	310.5	110.6	109.4	108.7
1965-1967	384.7	376.3	371.1	340.8	333.4	328.7	119.3	116.7	115.0
1967-1969	413.5	399.8	390.8	366.4	354.2	346.2	128.2	124.0	121.2
1969-1971	443.9	423.7	411.5	393.5	375.5	364.6	137.7	131.4	127.6

Biennium	Allotment for County Highway System			Allotment for Road District System			Allotment for Municipal Street System		
	High	Medium	Low	High	Medium	Low	High	Medium	Low
1961-1963	$67.9	$67.6	$67.4	$29.5	$29.5	$29.3	$ 94.4	$ 94.1	$ 93.9
1963-1965	72.6	71.9	71.4	31.6	31.2	31.1	100.1	100.1	99.4
1965-1967	78.4	76.7	75.6	34.1	33.4	32.9	109.1	106.6	105.2
1967-1969	84.3	81.4	79.6	36.6	35.5	34.6	117.2	113.3	110.8
1969-1971	90.5	86.4	83.9	39.4	37.6	36.5	125.9	120.2	116.6

*Gross total cash MFT revenue less refunds, (10 percent of gross); administrative and collection expenses (1.1 percent of gross); and $1,200,000 Grade Crossing Protection Fund Allotment.

Projections of Registration Fees

Motor vehicle registration fees and operators' license fees are projected as a single revenue source by the same technique used to project motor fuel tax revenues.[18] A range of total gross registration fees available by bienniums, 1961-1963 through 1969-1971, is given in Table 13.

TABLE 13

Projected Gross Total Registration Fees, by Biennium, 1961-1963 through 1969-1971
(In millions of dollars)

Biennium	Gross Total Registration Fees		
	High	Medium	Low
1961-1963	$239.5	$237.4	$236.4
1963-1965	278.4	272.5	268.3
1965-1967	325.0	310.9	302.2
1967-1969	372.9	350.2	335.1
1969-1971	423.7	390.1	369.7

Projection of Federal Aid

Federal aid for Illinois highways is apportioned by Congress for the federal-aid primary, secondary, urban, and Interstate systems, and for miscellaneous purposes including forest highways and, upon occasion, flood relief. The amount of federal aid revenue apportioned to Illinois or to any state in a given year depends upon the amount of revenue estimated to be in the Federal Highway Trust Fund at the time of the expenditures from the trust fund are expected to be made. Apportionments to the states are reduced if a deficiency should occur in the trust fund. In this manner, the Highway Trust Fund, established by the Federal-Aid Highway Act of 1956 and in effect until October 1, 1972, places the federal-aid systems on a pay-as-you-go basis. Estimation of the total amount of federal aid for highways in any one year, therefore, involves projection of revenues available for the Highway Trust Fund. The U.S. Bureau of Public Roads prepared such an estimate of revenues and expenditures for the Interstate and A-B-C systems (federal-aid primary, secondary, and urban systems) in conjunction with the Federal-Aid Highway Act of 1961. The 1961 Act provided for extensions and increases in taxes designed to furnish sufficient revenue to

[18] Note on methodology: The estimating equation is Yc equals a minus bX, where Yc is gross motor vehicle registration fees and operators' license fees; (a) is the constant, minus $82,910,000; (b) is the regression coefficient, .007; and (X) is Illinois real personal income in a given fiscal year. The coefficient of correlation, (r), is .9360. The standard error of the estimate is $5,200,000. The range within which the estimate of gross registration fees can be expected to fall ninety-five times out of one-hundred in any fiscal year, 1962-1971, is the estimate for that year plus and minus $10,100,000. Data were in 1961 dollars and centered on January 1 of each year.

pay the estimated $37 billion federal share of the cost to complete the Interstate System by 1972, and at the same time maintain a sufficient level of expenditure on other federal-aid systems. Apportionments, expenditures and revenues projected by the Bureau on the basis of 1961 tax rates are presented in Table 14.

Illinois is to receive 5.268 percent of the annual apportionments of federal aid for the Interstate System during fiscal 1963-1966.[19] The proportion 5.268 has been applied to estimated fiscal-year apportionments to determine the share which will be allotted to Illinois on the average over the period 1962-1971. The amounts that Illinois can expect to receive of total federal apportionments for the Interstate System are given in Table 15 for bienniums 1961-1963 through 1969-1971.

The annual apportionment of federal aid allotted to Illinois for the A-B-C systems has consistently been around 4.4 percent of the total annual federal appropriation for these systems. Since the apportionment formulas are based upon population, area, and mileage of rural delivery and star routes, and these variables change slowly, this percentage will be relatively stable over a period of time. On the other hand, the share of total expenditures of federal aid on the A-B-C systems that has come to Illinois in the period, 1950-1960, has averaged 4.6 percent of total federal expenditures for these systems, with annual expenditures varying from 3.0 to 6.4 percent. A wide range of expenditure is to be expected in this case, because the apportionments are expended as construction is completed and not when Congress authorizes the funds to be made available. Assuming that Illinois will continue to be apportioned and will spend annually on the average of 4.4 percent of total federal expenditures, the state would receive the amounts shown in Table 15 as federal aid for the A-B-C systems.

Projection of Miscellaneous Revenues

Miscellaneous state highway revenues include fines, penalties, refunds from counties and municipalities, as well as other less important sources such as payment by State Highway Police for lost equipment, and reimbursements from other states, individuals, and railroads for their share of cooperative projects performed by the Division of Highways. Miscellaneous revenues have been a consistent percentage of revenues received from the motor fuel tax, registration fees and federal aid. Prior to 1958, when federal aid increased sharply, miscellaneous receipts were typically from 2 to 3 percent of the total of these receipts. Miscellaneous revenues have been 2 percent annually of these receipts from 1958 to 1961. Assuming this rela-

[19] The proportion each state receives is based upon the ratio of the estimated cost to complete the Interstate System in the state to the total cost to complete the entire system. A 1960 cost study indicated that the estimated cost to complete the designated Illinois system of Interstate routes will be $1,558,039,000, which increased Illinois share of appropriations 2.7 percent from the 5.128 allowed for 1960-1962. Future cost estimates to derive new proportions will be made in 1966, 1967, 1968 and for fiscal years following until the Interstate System is completed. The percentage received by Illinois on the basis of these future estimates may vary substantially from the present 5.268 percent. Such a difference is indicated by the variance among proportions allotted to the states on the basis of the 1957 and 1960 cost studies. Possible changes in the mileage and location of routes, changing price levels within the states, and differentials in time of completion of routes could change the ratio for any one state over time.

tionship will continue during fiscal 1962-1971, Table 16 gives the revenue available to the Division of Highways from these miscellaneous sources for the bienniums, 1961-1963 through 1969-1971.

Projection of Appropriations from General Revenue and Bond Issues

The two remaining sources of revenue available for expenditure by the Division of Highways are appropriations from the General Revenue Fund and bonds. No revenues are anticipated from the General Revenue Fund during the period, fiscal 1962-1971. Appropriations from the General Revenue Fund in the past have been for the purposes of administering the safety responsibility law and maintenance of certain highways constructed under special appropriations. These expenditures are now made from revenues collected for highway purposes and no General Fund appropriations have

TABLE 14

Estimated Status of the Highway Trust Fund Under the Provisions of the Federal-Aid Highway Act of 1961

(In millions of dollars)

Fiscal Year	Apportionments		Expenditures		Revenues	Balance in Fund June 30
	Interstate	A-B-C*	Interstate	A-B-C*		
Before 1957	$ 140	$ 965	$ —	$ —	$ —	$ —
1957	1,175	829	208	758	1,482	516
1958	1,700	859	675	836	2,044	1,049
1959	2,200	1,381	1,501	1,112	2,087	523
1960	2,500	906	1,861	1,079	2,536	119
1961	1,800	883	1,901	967	2,857	108
1962	2,200	884	2,139	913	3,227	283
1963	2,400	925	2,326	898	3,319	378
1964	2,600	925	2,451	927	3,409	409
1965	2,700	925	2,552	923	3,495	429
1966	2,800	925	2,645	932	3,576	428
1967	2,900	925	2,739	949	3,654	394
1968	3,000	925	2,838	958	3,731	329
1969	3 000	925	2,886	972	3,807	298
1970	3,000	925	2,901	977	3,887	307
1971	2,885	925	2,992	979	3,976	312
1972	—	925	3,104	966	4,070	312
Thru Sept. 30, 1972	—	—	1,301	317	1,471†	165
Total	$37,000	$16,057	$37,000	$15,463	$52,628	—

SOURCE: *U. S. Code, 1961*, Vol 2: *Legislative History*. Tables 7 and 8, p. 1821. Prepared by the U. S. Bureau of Public Roads.

*Includes emergency relief program, as well as special funds totaling $502,000,000 apportioned for 1959.

†Receipts on tax liabilities accrued prior to September 30, 1972.

been made since 1957. The last issue of bonds made directly by the state for highway purposes was in 1923 to complete what is now known as the State Bond Issue system of highways. No further issues are anticipated during 1962-1971.

Total Projected Highway Revenues

Total state revenues available for highway purposes are given in Table 17 by biennium, 1961-1963 through 1969-1971. From these revenues, expenditures will be made for the construction, maintenance, and operation of the state highway system, as well as payment to other State Departments and motor fuel tax transfers to local highway authorities for use on their respective road systems.

Total highway revenues available during the bienniums, 1961-1963 through 1969-1971, when combined with the balances existing in highway funds (Road Fund, Motor Fuel Tax Fund, Grade Crossing Protection Fund) at the beginning of the 1961-1963 biennium, are indicative of potential highway expenditures during the next ten years, but expenditures in any

TABLE 15

Projections of Federal Aid Revenues Available for Illinois Highway Purposes, by Biennium, 1961-1963 through 1969-1971
(In millions of dollars)

Biennium	Total Federal Aid	Interstate Revenue	A-B-C Revenue
1961-1963	$321.9	$242.3	$79.6
1963-1965	360.6	279.2	81.4
1965-1967	381.7	300.3	81.4
1967-1969	397.4	316.0	81.4
1969-1971	391.4	310.0	81.4

TABLE 16

Projections of Miscellaneous Revenues Available for Highway Purposes, by Biennium, 1961-1963 through 1969-1971
(In millions of dollars)

Biennium	Miscellaneous Revenues*		
	High	Medium	Low
1961-1963	$17.9	$17.8	$17.8
1963-1965	19.9	19.7	19.6
1965-1967	21.8	21.4	21.1
1967-1969	23.7	22.9	22.5
1969-1971	25.2	24.1	23.5

*Includes fines, penalties, refunds from counties and municipalities and other sources.

biennium will not equal that biennium's revenue because of lapses in expenditures. For example, the time periods from the date of allotment of federal aid and the completion of construction can overlap two or more bienniums. This lag of expenditures has not been accounted for in the preceding projections of federal aid and total highway revenues.

The three levels of projected state highway revenues for the 1961-1963 biennium in Table 17, when added to the $144.3 million total balances in highway funds at July 1, 1961, gives the total resources estimated available for expenditure on highways for that biennium, i.e., high estimate, $1,023.8 million; medium estimate, $1,020.4 million; and low estimate, $1,018.7 million.[20]

TABLE 17

Total Projected Revenues Available for Highway Purposes, by Biennium, 1961-1963 through 1969-1971*

(In millions of dollars)

Biennium	High	Medium	Low
1961-1963	$ 879.5	$ 876.1	$ 874.4
1963-1965	979.9	970.7	964.0
1965-1967	1,074.7	1,052.7	1,039.0
1967-1969	1,166.1	1,130.3	1,106.7
1969-1971	1,239.8	1,186.9	1,154.9

SOURCE: Tables 11, 13, 15, 16.
*Net of MFT refunds.

Highway expenditures are made to accommodate the character and volume of both present and anticipated traffic. Improvement of the highway system has been a continual process necessitated by ever-increasing demands for a more adequate system. At the present, for instance, outlays made for the Interstate System are providing facilities constructed to standards believed suitable for 1975 traffic. Disbursements per vehicle mile traveled gives an indication of the ability of expenditures to keep pace with increased highway usage (see footnote 5).

Vehicle travel on Illinois highways increased 860 million miles a year on the average from 1950 through 1961. If travel continues to increase each year by this amount, total vehicle miles traveled in the 1965-1967 biennium will be about 83.9 billion miles, and in the 1969-1971 biennium, 90.7 billion miles. The increased travel will result in an increasing intensity of use

[20] Receipts for highway purposes have been estimated by the Department of Finance to total $1,136.4 million in the 1961-1963 biennium. Addition of the total balances in all highway funds of $144.3 million to this estmate gives $1,280.7 million available for highway purposes. Approximately $200 million of this total represents authorizations to complete projects started prior to July 1, 1961. Another $28 million is estimated to comprise MFT refunds. Deduction of these amounts from total 1961-1963 biennium resources gives $1,052.7 million, which is roughly comparable to the estimated $1,023.8 million to $1,018.7 million range established by the preceding projections. See State of Illinois, Department of Finance, *Financial Program for Illinois for 72nd Biennium, 1961-1963*, pp. 16, 26, 30.

of Illinois highways, the total mileage of which can be expected to remain relatively constant. State revenues available for highway purposes in the 1965-1967 biennium total $1,052.7 million (medium estimate), and in the 1969-1971 biennium, $1,186.9 million (medium estimate). Potential disbursements per one thousand vehicle miles traveled on all Illinois highways would be about $12 in the 1965-1967 biennium and $13 in the 1969-1971 biennium, with no allowance for lapsed expenditures or fluctuating balances in highway funds. Annual disbursements per thousand vehicle miles were about $11 for the 1959-1961 biennium. Slightly more can be expended in relation to highway usage over the next ten years. Real outlay could be reduced, however, by increasing construction prices. As previously noted, the index of construction prices has fluctuated around the same level over the past ten years (see Table 6). Whether this circumstance will continue depends upon demand and supply conditions for cement, steel and other road building materials, as well as wage levels and equipment costs. Continued inflationary trends, eventual evaporation of the present excess capacity in the cement industry, and prospects of generally rising wages and property values, indicate that construction prices and right-of-way costs will at least remain at the level of the past ten years and perhaps rise slightly.[21] The trend to heavier vehicles traveling at increased speeds will also influence construction expenditures as higher-type and more costly highways will be necessary to accommodate such traffic adequately.

A substantial portion of anticipated state highway revenues will be needed for expenditures on the Interstate and other federal aid systems during fiscal 1962-1971. About $561 million or 17 percent of the total $5,216.7 million projected revenues (medium estimate) will be needed to match anticipated federal aid for all systems. Total expenditure on the federal aid systems in the next ten fiscal years could equal $2,368.4 million (federal aid plus state matching funds), or 45 percent of total revenues for fiscal 1962-1971.[22] The $2,368.4 million expenditure for improvement of the federal aid systems is paid from the Road Fund administered by the Division of Highways. Anticipated Road Fund revenues are expected to total $4,104.5 million during fiscal 1962-1971 (medium estimate).[23] About 57 percent of future Road Fund revenues are likely to be expended on federal aid highways during fiscal 1962-1971. The remaining 43 percent of Road Fund revenue, about $1,736.1 million, would be available for construction on non-federal aid systems; maintenance and operation of the state highway system; administration and overhead expenses of the Di-

[21] Past efforts to predict the future level of construction prices have not been notably successful. See: Griffenhagen and Associates, *op. cit.*, pp. 108-109.

[22] No allowance is made for balances in highway funds on July 1, 1961 or for matching the $200 million of federal aid previously allotted and carried over into the 1961-1963 biennium. These balances and lapsed expenditures will be somewhat offset by similar balances and lapses at the end of the 1969-1971 biennium.

[23] Road Fund revenues include the total of projected registration fees (Table 13, medium estimate); the share of MFT revenues allotted to the State (Table 12, medium estimate); total federal aid revenue (Table 15); and projected miscellaneous revenues (Table 16, medium estimate).

vision of Highways; and appropriations to other State Departments for highway-related purposes, including policing, etc.

The large amounts of future revenue devoted to improvement of the federal aid highway systems coupled with the demonstrated tendencies of other disbursements made by the Division of Highways to increase over time indicates that state highway revenues will not increase more rapidly than expenditures. The prospect of increased maintenance and operation expenditures necessitated by further development of the Interstate System supports this contention.

At December 31, 1960, 333.8 miles of Interstate routes had been completed in Illinois, although an additional 158.4 miles were adequate for present traffic but were not improved to Interstate standards. Of the total 1,586.5 miles of Illinois Interstate highways, about 70 percent remained to be constructed. Over 100 miles will have to be added each year on the average to complete the system by the 1972 target date. Even though the system may not be developed this rapidly, maintenance and operation expenditures can be expected to increase during 1961-1972 as additional mileage is added. Interstate highway maintenance and operation costs per mile can be expected to be higher than similar costs for other highways maintained by the state. In part, this differential is due to the additional width of the wearing surface, wider shoulders, roadsides, and medians, larger bridges, more guardfence and other physical characteristics of the high-type facility. Heavy traffic volumes also influence freeway maintenance and operation expenditures, however, since these facilities are located to accommodate the heaviest traffic volumes and have the ability not only to divert traffic from alternate, and possibly more direct routes, but also are capable of generating additional traffic. The expected increases in maintenance and operation expenditures for the Interstate System will be in addition to increasing outlays for these purposes on other highways maintained by the state. Future increases in travel over the state highway system combined with rising costs should cause these disbursements to continue to rise. Since 1957, maintenance and operation expenditures have accounted for 8 to 9 percent of total disbursements. Prior to 1958, these expenditures had been around 11 percent of total disbursements. During fiscal 1962-1971, maintenance and operation expenditures should account for an increasing share of total disbursements, with the rate of increase controlled by the rapidity of development of the Interstate System; the growth of travel over the state highway system; and rising costs of performing the maintenance and operation functions.

CHAPTER VII

FORECASTS OF ILLINOIS STATE REVENUES AND EXPENDITURES

By Case M. Sprenkle*

Forecasters are fortunate in that people are usually too uninterested in their work to notice when the forecasts have gone astray, and when they do notice are usually kind enough to forego any extended criticism. If the forecasts are long run, the forecaster has the further advantage that his work will be forgotten long before it can be proved wrong. In order to further disarm the reader as to the nature of this study, it must be emphasized that nobody can reasonably expect the forecasts developed here to be accurate. This is not to say that these forecasts are worse than most others, but rather that they are intended to show what would happen if certain highly unlikely events occur.

The primary purpose of this study is to estimate the extent to which the *present* State tax structure will be able to provide the revenue necessary to meet estimated expenditure needs in the future. If it is found that the present tax structure will provide adequate revenue to meet the expenditure needs of the State, then the conclusion can be drawn that no change in the tax structure is needed, but if it is found that the revenues will be much less than expenditures, then the conclusion would be that the present tax structure will have to be changed by increasing the tax rates of existing taxes and/or the addition of new taxes. The work of this study, then, involved the forecasting of revenues to be obtained from the present State tax structure through 1971 and of the expenditure needs of the State through 1971. As will be detailed below the individual expenditure category projections were primarily made by others. In addition projections were also made of Local revenues and Federal aid to the State and Local governments, but no attempt was made to forecast future Local expenditures.

It should be clear now why these forecasts are not at all likely to prove accurate. First, it is obvious that the State (and Local) tax structure will not remain as it is at present. Additions to certain tax rates, changes of the bases of some taxes, and the installation of new taxes will certainly occur in the next few years. Second, the forecasts of expenditures are primarily on the basis of needs. If adequate revenues are not forthcoming to meet these needs, expenditures will be curtailed, and the level of government services will fall. Thus the estimates of expenditures presuppose reasonably adequate methods of financing. The results of this study indicate that the present tax structure will be totally inadequate long before 1971. Thus either substantial changes in the tax structure will be made to increase revenues, or expenditures will

*The author is Assistant Professor of Economics at the University of Illinois. The author wishes to thank William Habacivch and Roger L. Miller for their help in collecting data and computations.

be reduced far below the forecast level causing a curtailment of government services below the present level. In either case these forecasts will be inaccurate.

The Revenue Forecasts

Revenue forecasts were made for several of the most important State taxes as well as for what appear to be the most relevant subtotals of State revenues, for several local taxes, and for Federal aid. The basic assumption of all these forecasts is that revenues in the future will vary in the same manner with respect to Illinois Per Capita income as they have done over the decade of the 1950's. Many factors will affect revenues from particular taxes, but the one most important determinant is income for all the most important taxes. Other variables were used for some of the taxes; for instance, retail sales estimates were used to try to explain Retailers' Occupation Tax revenues as well as receipts from the cigarette and liquor taxes, and motor vehicle registration figures were used for gasoline tax revenues and auto license fees. Only in the case of motor vehicle registration to explain gasoline tax revenues is there a significant relationship, and even here it does not appear to affect the forecasts significantly.

The fact that income is the most important determinant of revenues does not completely determine the methods to be used, for there are several different kinds of income which might be used and also several different forms of the relationship between income and revenues which might be hypothesized. The best possibilities for income are Illinois personal income and Illinois per capita income; the latter being Illinois personal income divided by Illinois population. Both kinds of income were tried and no significant difference was found in the results. Per capita income was chosen because the use of personal income raises the question of whether population should be included also as a separate determinant of revenues, and it was found that there were statistical difficulties in trying to estimate the relationship between revenues and both personal income and population. Several types of relationships between per capita income and revenues were tried. These included the relation between dollars of income and dollars of revenue, changes in income and changes in revenue, and percentage changes in income and revenue. The last relationship proved to be the best, as would be expected since percentage changes are apt to be more stable over relatively long periods of time than are dollar changes. For all of the various revenue categories, then, the relationship used fas of the form $ln\ R = a + b\ ln\ Y$, where R is any of the particular revenue categories and Y is Illinois per capita income. The statistical problem is to estimate values of a and b for the equation for each of the revenue categories. The value of b is of particular importance since it determines the percentage change in revenues resulting from any given percentage change in per capita income.[1]

[1] It does not, however, precisely measure what economists call "income elasticity" since it relates changes in per capita income to changes in *total* revenues.

Estimates of *a* and *b* for the various categories of revenues were made from data for the fiscal years 1951 to 1961. In order to determine the actual relations between revenues which would have been obtained from the present (fiscal 1963) tax structure and per capita income over the decade of the fifty's, adjustments had to be made in the original figures of revenues collected for each year. Some of the increase in revenues over this period was caused not by real growth of the State's economy, but rather by inflation. All forecasts of revenues should be in constant dollars to correspond with the forecasts of expenditure needs of the State which are, and should be, in constant dollars. Therefore all revenues were deflated by the Consumer Price Index to take account of changes in the price level. Further adjustments in the original revenue figures were necessary for those taxes for which there have been changes in the rates or bases over the decade. Some of the changes in revenues from individual taxes over the decade have been caused solely by changing the base of the tax and/or changing the tax rates. We are interested in estimating what revenues would have been in the past if present bases and rates had been in effect; therefore, adjustments of the revenue figures were made whenever such changes occurred with respect to most of the major taxes. For some taxes and fees which are of relatively minor importance (in terms of revenue derived from them) and for several rather important taxes (such as auto license fees and liquor taxes) where it seemed difficult to determine exactly by what amount rates increased, no adjustment for changes was made. For these taxes, then the estimates of the amount by which these revenues change with changes in income will be overstated to some extent and therefore the forecasts of future revenues to be obtained from these sources will be overstated. For major taxes with easily defined changes in their rates or bases some sort of arbitrary adjustment method had to be chosen. The method used assumes that if tax rates increase by some percent, then revenues obtained will also increase by that extent. For example, if the ROT rate had been 3½ percent during the period when it was actually 3 percent, we assume that revenue each year would have been one-sixth higher than it actually was, and the adjustment consisted of multiplying the actual revenues by 7/6. This method of adjustment is arbitrary since it assumes that any changes in tax rates will not affect the amount of the taxed goods purchased; that is, it assumes a perfectly inelastic demand. This assumption is not exactly true in most cases, but it can be argued that it probably is not far off in most of the situations where it was used since demand is highly inelastic for cigarettes and gas and probably in general for items taxed under the ROT. To the extent that the assumption is not warranted in any particular case, the adjusted revenues will be too high, and therefore, the change in revenues over the decade will be understated. This will lead to some understatement of future revenues from these taxes. Several new taxes have been added so recently (e.g. the SOT and Hotel and Motel Tax) that it is impossible to determine the relation their

revenues have to income levels. In these cases the assumption was made that they will behave in the fashion of similar taxes. In the case of the SOT and Hotel and Motel Tax in particular it was assumed that changes in their revenues will be similar to changes in ROT revenues. It is likely that the revenues from these two taxes will increase at a faster rate than ROT revenues and therefore future revenues from these sources is probably somewhat understated. For these reasons not too much faith should be put in the estimates of revenues from individual taxes during the fifties as shown in Table 1. Since revenues from taxes which were not adjusted may be overstated and revenues from taxes where adjustments were made may be understated, it is hoped that these possible biases will balance out so that the revenues from major categories of taxes will be much more accurate than the individual tax figures. For example, the Total State Non-highway revenue figures in Table 1 should be much more accurate than the estimates of revenues from the ROT group of taxes or the Public Utility Tax, etc.

Some of the implications of the results shown in Table 1 are striking. One of the most important criticisms of state tax structures is that they result in inelastic revenues with respect to income. That is, the tax structures are so set up that as incomes rise by a certain percentage, tax revenues will rise by a smaller percentage. This result coupled with the normal situation that as incomes and population rise over time the expenditure needs of the state governments will rise at a greater rate means that the state is likely to have financial problems unless new sources of revenue are found. Allied with this problem is the related one that an inelastic tax structure over time usually implies a regressive tax structure at any point in time. That Illinois' tax structure is subject to this criticism can be seen from Table 1. None of the major categories of revenues increased at as high a rate as Illi-
creased 22 percent from 1951 to 1961, which is an average annual increase of
nois Personal Income. For instance, Total State Non-highway Revenues increased 22 percent from 1951 to 1961, which is an average annual increase of 2 percent; Total State Revenue, Total Local Revenue, Total State and Local Non-Highway Revenue, Total State and Local Revenue, and Total Non-Highway State and Local Revenue and Federal Aid all increased at an average annual rate of between 2 percent and 2.25 percent. Because of the very large increases in Federal Highway Aid, Total State and Local Revenue and Federal Aid increased at about 2.8 percent. In comparison Illinois Personal Income during this same period increased at an average annual rate of 2.85 percent. These results indicate that as incomes rise in the future, there will be a less than proportional rise in revenue. Most governmental units have found that as incomes rise the expenditure needs of the government will rise in at least as great a proportion as incomes. The forecasts of expenditures described below indicate that this will be true for Illinois in the next decade, and thus the present tax structure will be found inadequate to meet these needs.

TABLE 1
Adjusted Revenues*
(Millions of 1961 Dollars)

Year	ROT, SOT Use and Hotel	Liq. Gal.	Pub. Util.	Cig. Tax	Ins. Tax	Inher. Tax	Corp. Franchise	Ill. Cent.	Racing Taxes	Int. on Funds	Misc. Fees and all other Receipts	Total State Non-Hy.	Motor Fuel Tax
1951	500.1	39.1	25.4	44.0	13.9	10.5	4.9	5.8	13.0	2.8	37.8	697.2	125.2
1952	487.4	31.8	26.3	43.8	28.2	13.2	4.7	5.6	15.1	2.3	31.4	689.8	119.5
1953	514.0	34.4	27.9	46.0	22.5	14.2	5.0	5.7	18.8	3.4	36.5	728.4	124.1
1954	515.6	34.4	30.3	46.7	24.8	13.8	5.3	5.3	17.6	3.6	43.9	741.3	127.4
1955	502.5	32.4	33.0	44.1	21.9	16.9	4.8	4.9	18.8	2.4	43.8	725.5	134.5
1956	486.0	36.1	35.7	47.3	28.8	22.0	6.5	5.2	19.4	2.8	43.7	733.5	138.4
1957	554.1	34.5	37.1	47.0	27.4	21.6	5.3	4.9	19.5	4.0	43.8	799.2	140.0
1958	536.2	32.6	39.0	50.0	24.1	21.3	5.4	4.3	18.5	4.9	64.3	801.6	141.1
1959	530.2	33.9	40.8	50.1	33.6	21.8	6.9	4.3	17.8	4.2	63.1	806.7	142.4
1960	527.1	32.2	45.5	50.2	29.3	22.4	5.7	4.0	18.2	6.1	64.5	805.2	144.5
1961	538.1	41.0	47.0	51.5	31.4	33.8	7.7	3.6	18.5	7.1	63.0	842.7	147.5

Year	Mot. Veh. Dr. Lic. Auto Title	Total State Rev.	Local Property Tax	Local Fees and Misc. Receipts	Total Local Revenue	Total State and Local Non-Hiway	Total State and Local	Federal Highway Aid	Federal Welfare Aid	Other Federal Aid	Total Non-Hy. State, Local and Fed. Aid	Total State Local and Fed. Rev.
1951	71.1	893.5	1031.2	226.0	1314.4	2011.6	2207.9	16.7	59.4	27.5	2098.5	2311.5
1952	72.6	882.0	1079.4	229.2	1364.4	2034.2	2246.4	23.0	62.6	31.1	2147.9	2363.1
1953	77.8	931.4	1092.0	235.6	1386.4	2114.8	2317.8	31.2	61.9	29.1	2205.7	2439.9
1954	81.2	949.7	1085.5	240.7	1385.1	2126.5	2334.4	30.1	68.7	26.9	2222.0	2461.0
1955	83.3	944.3	1105.7	248.0	1411.1	2136.6	2355.3	30.2	72.6	23.7	2232.9	2481.8
1956	90.4	962.3	1151.5	253.6	1461.1	2194.6	2423.4	41.4	66.9	27.2	2288.7	2558.9
1957	98.6	1037.8	1156.6	254.9	1475.2	2274.4	2513.0	39.2	73.6	31.9	2379.8	2657.6
1958	97.9	1040.6	1225.5	256.7	1542.8	2343.4	2582.4	56.9	78.0	36.7	2458.1	2754.0
1959	100.2	1049.4	1245.9	263.8	1570.4	2377.1	2619.8	116.2	82.0	43.5	2502.6	2861.4
1960	103.6	1053.3	1292.8	270.0	1622.3	2427.5	2675.5	200.2	99.0	42.7	2569.2	3017.5
1961	104.9	1095.2	1308.3	278.4	1647.5	2430.2	2742.7	177.5	96.6	46.5	2633.3	3063.2

*Adjusted for changes in tax rates and tax bases to reflect revenues which would have been obtained in each year with 1962 State tax rates and bases. Includes estimated receiptsfrom SOT and Hotel and Motel Tax. Source for original data: Illinois Department of Finance, *Annual Reports.*

In order to obtain forecasts of future Illinois revenues the data of Table 1 were used with figures for Illinois Per Capita Income to determine the relation between the various revenue categories and income which has held over the recent past. That is, estimates of b in the equation above were obtained for each revenue category. These estimates along with forecasts of Illinois Per Capita Income for the next decade determined the forecasts of the various revenue categories. The forecasts of Illinois Per Capita Income are, thus, a crucial determinant of the revenue forecasts. Four forecasts of Per Capita Income were used; the lowest on the basis that it will grow at the same rate it has over the last decade, and the highest three on the basis of the work of Ferber and Ford.[2] For an explanation of the latter three forecasts the reader is referred to Ferber and Ford. Corresponding to the four forecasts of Illinois Per Capita Income used are four series of forecasts of Illinois Personal Income. The four growth rates forecast for the latter are 2.85 percent, 3.0 percent, 3.5 percent, and 4.75 percent where 2.85 percent is the actual growth rate over the last decade, and 3.0 percent, 3.5 percent, and 4.75 percent are the forecasts of Ferber and Ford.

Table 2 shows the revenue projections by biennium for the major categories of revenues on the basis of each of the four income forecasts. Forecasts of revenues from individual taxes were made only for the ROT and related taxes, the Motor Fuel Tax, and the Local Property Tax. In addition to the revenue categories previously described, forecasts were also made of revenues going into the General Revenue Fund both excluding and including revenues going into the Common School Fund, which will expire this year unless there is legislative action to extend it. The results of Table 2 show that substantial increases in revenues can be expected during this period. In fact, of course, the low forecasts based on the historical growth rate of 2.85 percent of Illinois Personal Income should show the same rate of increase as has actually obtained over the previous decade. The forecasts based on the larger growth rates of income will show correspondingly larger increases. For instance, the high forecast of Total State Non-Highway Revenues for the 1969-1971 biennium is 51 percent over these revenues for the 1959-1961 piennium. The similar figures for Total State Revenue and Total State and Local Revenue and Federal Aid are respectively 64 percent and 74 percent.

The present tax structure in Illinois will yield substantial increases in revenue in the future. The crucial question is, will these increases be enough to match the increased expenditure needs to be expected? In order to determine this we need to examine the prospects for future expenditures.

The Expenditure Forecasts

Expenditure forecasts for the various major categories of expenditures were made by the various members of the staff of the Illinois Commission on

[2] Robert Ferber and Neil Ford, "The Projected Economic Growth of Illinois to 1971," Report for the Illinois Commission on Revenue.

TABLE 2
Biennium Revenue Projections
(Millions of 1961 Dollars*)

	63-65				65-67				67-69				69-71			
	Low 2.8%	Low 3.5%	Med. 4.0%	High 4.7%	Low 2.8%	Low 3.5%	Med. 4.0%	High 4.7%	Low 2.8%	Low 3.5%	Med. 4.0%	High 4.7%	Low 2.8%	Low 3.5%	Med. 4.0%	High 4.7%
ROT., SOT., Use & Hotel	1104.8	1124.9	1132.0	1142.7	1121.4	1152.1	1166.8	1188.9	1138.5	1174.2	1196.7	1231.1	1156.1	1199.8	1231.4	1278.8
General Revenue excluding Common School	1434.8	1483.3	1504.5	1537.1	1488.5	1563.4	1608.8	1678.8	1544.2	1629.6	1700.8	1813.3	1602.0	1710.2	1811.5	1972.2
General Revenue including Common School	1590.6	1644.2	1667.6	1703.7	1646.7	1729.3	1779.4	1856.6	1704.7	1798.8	1877.2	2000.1	1764.9	1883.9	1995.0	2171.6
Total State Non-Highway	1804.2	1864.8	1891.3	1932.0	1875.6	1969.4	2026.2	2113.8	1949.8	2057.1	2146.3	2287.3	2027.0	2163.4	2290.4	2492.3
Motor Fuel	317.3	329.4	334.5	342.4	330.8	349.6	360.7	377.6	344.8	366.7	384.1	411.6	359.5	387.6	412.4	452.1
Total State Revenue	2360.4	2454.6	2493.7	2553.9	2463.2	2610.0	2694.6	2824.5	2570.5	2740.8	2874.9	3089.3	2682.3	2901.5	3092.9	3511.8
Local Property Tax	2843.3	2945.2	2993.9	3069.1	2981.4	3139.5	3245.2	3408.0	3126.3	3304.1	3471.7	3737.6	3278.3	3506.7	3746.6	4132.8
Total Local Revenue	3568.4	3689.5	3747.9	3838.0	3734.5	3921.8	4048.3	4242.6	3908.2	4118.1	4318.0	4634.3	4090.1	4359.1	4644.4	5102.1
Total State & Local Non-Highway	5361.2	5553.8	5638.8	5769.4	5591.3	5890.3	6073.6	6354.5	5831.3	6173.8	6462.8	6918.6	6081.5	6520.6	6932.4	7589.8
Total State & Local Revenue	5924.8	6144.3	6241.8	6392.1	6191.2	6532.2	6743.2	7067.5	6469.4	6959.9	7193.3	7721.1	6760.3	7261.4	7737.8	8501.5
Total Non-Highway State, Local, & Federal Aid	5708.7	5908.0	6003.0	6149.4	5977.2	6286.0	6455.8	6807.9	6258.6	6605.5	6892.6	7446.0	6553.1	6997.3	7421.4	8208.7
Total State, Local & Federal Aid	6779.2	7062.1	7201.6	7417.1	7182.3	7624.8	7931.8	8406.2	7609.3	8107.4	8600.0	9387.1	8061.5	8706.5	9421.4	10584.1

*Projected on the basis of Illinois personal income projections. The first column for each biennium is based on the assumption that personal income in Illinois will increase at an annual rate of 2.8%. This rate is the average for Illinois for the decade 1951-1961. The last three columns are based on the assumption that Illinois personal income will grow at the rates of 3.5%, 4.0%, and 4.75% respectively. These latter rates are based on the projections of Ferber and Ford.

Revenue in the course of their other work in these areas. The purpose of this report is not to present alternative forecasts of these major expenditure categories, but rather to compile their forecasts in order to obtain figures on total expenditures forecast. The reader is referred to the original reports for descriptions of the forecasting methods and assumptions used.

Expenditure projections were made only for expenditures out of the General Revenue Fund and for total State non-highway expenditures. Projections of local expenditures were not attempted both because of a lack of sufficient data to make accurate projections, and because any such projections would be of substantially less use to the Revenue Commission. Projections of highway related expenditures were not included here since it was assumed in the report on highway expenditures by Racster that these expenditures would be equal to revenues from the various highway related taxes.[3] The major interest here, then, is to develop projections of State non-highway expenditures, and to compare these expenditures with revenues available for such purposes.

The results of the forecasts of major expenditure categories are shown in Table 3. Forecasts are shown in the table for total expenditures in each category and for expenditures out of General Revenue Funds (shown in parentheses). The forecasts of expenditures for Vocational Education are from Table XVIII, of the report of Gallington.[4] All these expenditures have been assumed to be out of the General Revenue Fund as they have been in the past. The forecasts of Public Assistance Expenditure are from Table XXVIII, of the report of Fisher.[5] The figures shown are for his expenditures for all programs out of state funds. Expenditures on Higher Education are taken from the report of McLure.[6] Total expenditures on higher education were obtained by summing his projections of educational and general expenditures shown in Table XX, and his projected capital expenditures shown in Table XXII. McLure estimates that 12.5 percent of the general expenditures shown in his Table XX will be financed from Federal Funds, so this amount was subtracted from his totals to arrive at our figures. McLure estimates that 7.5 percent of this total expenditure will be financed from earnings of the institutions, and $27.6 million will be payments on the Universities Bond Issue so these amounts were subtracted from the total to obtain expenditures on higher education financed from the General Revenue Fund. The expenditure forecasts of Public Safety, Public Health, and Mental Health are from Fisher.[7] It was assumed that the Mental Health Bond Issue would be financed in the same way as the Universities Bond Issue so these payments are subtracted from Total Mental Health Expenditure to obtain

[3] Ronald L. Racster, "State Highway Expenditures," Report for the Illinois Commission on Revenue.
[4] Ralph O. Gallington, "Vocational Education," Report for the Illinois Commission on Revenue.
[5] Glenn W. Fisher, "Public Assistance Expenditure," Report for the Illinois Commission on Revenue.
[6] William P. McLure, "Higher Education," Report for the Illinois Commission on Revenue.
[7] Glenn W. Fisher, Private correspondence with the author.

TABLE 3

Total State Non-Highway Expenditure Projections
Figures in Parentheses are Expenditures Out of the General Revenue Fund
(Millions of 1961 Dollars)

	63-65			65-67			67-69			69-71		
	High	Medium	Low	High	Medium	Low	High	Medium	Low	High	Medium	Low
Vocational Education	14.1	10.2	6.2	22.9	16.3	9.7	28.5	20.1	11.7	33.7	23.5	13.7
Ralph O. Gallington	(14.1)	(10.2)	(6.2)	(22.9)	(16.3)	(9.7)	(28.5)	(20.1)	(11.7)	(33.7)	(23.5)	(13.7)
Public Assistance Expenditure	478.3	429.9	376.2	582.5	492.5	417.1	709.6	559.0	460.5	867.4	628.9	505.7
Glenn W. Fisher	(478.3)	(429.9)	(376.2)	(582.5)	(492.5)	(417.1)	(709.6)	(559.0)	(460.5)	(867.4)	(628.9)	(505.7)
Higher Education	445.1	422.0	402.9	555.5	525.4	495.1	707.0	656.9	601.3	822.5	731.0	644.0
William P. McLure	(385.0)	(363.6)	(346.0)	(487.1)	(459.3)	(431.3)	(627.3)	(580.9)	(529.5)	(734.1)	(649.5)	(569.0)
Public Safety	55.2	43.4	31.7	43.9	38.8	33.9	47.2	41.7	36.2	42.8	40.5	38.4
Glenn W. Fisher	(53.5)	(42.1)	(30.7)	(42.6)	(37.6)	(32.9)	(45.8)	(40.4)	(35.1)	(41.5)	(39.3)	(37.2)
Public Health	19.6	19.6	19.6	20.2	20.2	20.2	20.7	20.7	20.7	21.3	21.3	21.3
Glenn W. Fisher	(19.6)	(19.6)	(19.6)	(20.2)	(20.2)	(20.2)	(20.7)	(20.7)	(20.7)	(21.3)	(21.3)	(21.3)
Mental Health	287.8	272.8	247.8	325.8	315.8	285.8	348.6	328.6	308.6	371.6	351.6	331.6
Glenn W. Fisher	(238.8)	(225.3)	(202.7)	(273.0)	(264.0)	(237.0)	(293.5)	(275.5)	(257.5)	(314.3)	(296.3)	(278.3)
Common Schools	430.0	425.4	420.8	510.6	493.0	475.3	588.3	548.2	508.1	655.9	596.7	537.4
Lawler, Bach & Griffin	(430.0)	(425.9)	(420.8)	(510.6)	(493.0)	(475.3)	(588.3)	(548.2)	(508.1)	(655.9)	(596.7)	(537.4)
Miscellaneous Expenditures	455.3	427.2	399.0	556.6	506.6	456.6	680.4	601.4	522.5	831.7	714.8	597.9
Case M. Sprenkle	(376.1)	(352.9)	(329.6)	(479.2)	(436.1)	(393.0)	(609.6)	(538.6)	(468.2)	(774.3)	(666.5)	(561.1)
Total Expenditure Projections	2185.4	2050.5	1904.2	2618.0	2408.6	21.93.7	3130.3	2776.6	2469.6	3646.9	3107.8	2690.0
Out of General Revenue Fund	(1995.4)	(1839.0)	(1731.8)	(2417.5)	(2219.0)	(2016.4)	(2923.3)	(2583.4)	(2291.3)	(3442.5)	(2922.0)	(2523.7)

expenditures out of General Revenue Funds. In addition a small part of Public Safety Expenditures are financed from the Road and Fire Prevention Funds. The forecasts of Common Schools Expenditures were obtained from the study of Lawler, Bach, and Griffin.[8] The low forecasts are from their Table XVI, Series 1, the high forecasts from their Series 3 projections, and the medium projection is the arithmetic mean of the high and low projections. It is assumed that all the Common School expenditures will be financed from General Revenue Funds.

In addition to these major expenditure categories, estimates of the remaining miscellaneous state expenditures were needed. Expenditures of approximately 60 state branches and agencies were not included in the major expenditure categories. Most of these expenditure items are quite small, but the sum total of these expenditures is large, $303 million for the 1959-1961 biennium. All of these expenditure items which were over $10 million for that biennium along with the sources of the funds are shown in Table 4. In addition to these relatively large items there were 46 additional items which totalled $81 million of expenditures for the biennium. The forecasts of the total of the miscellaneous expenditures was based solely on their growth in the past with no effect made to take account of prospective special considerations in any particular category. The high projection as-

TABLE 4
Major Categories of Miscellaneous Expenditure

Agency	Sources of Funds	Expenditure in Millions of Dollars
Secretary of State	General Revenue Fund	11
Dept. of Agriculture	Various Funds	22
Dept. of Conservation	Various Funds	21
Dept. of Public Works-Non-hgys.	General Revenue Fund	13
Dept. of Revenue	General Revenue Fund	15
Youth Commission	General Revenue Fund	17
Illinois Veterans Commission	General Revenue Fund	14
State Treasurer	Various BIR Funds	39
Supt. of Public Instruction	General Revenue & Driver Educ. Funds	49
Dept. of Registration & Education	General Revenue Fund	10
School Building Commission	General Revenue Fund	11
Total, Major Categories		222

SOURCE: Illinois Department of Finance, *Annual Report*, 1961.

sumes that these expenditures will grow at the rate they have grown during the last two bienniums. The low projection assumes that these expenditures will grow at the rate they have grown on the average over the last decade, and the medium expenditure projections are the arithmetic average of the high and low projections. The percentage of these expenditures which came out of earmarked funds has been decreasing over the last decade. The

[8] Eugene S. Lawler, Jacob O. Bach, and Edward Griffin, "The Common Schools," Report for the Illinois Commission on Revenue.

projections of these expenditures out of General Revenue Funds were made on the basis that this decrease in the earmarking of these funds would continue at the same rate.

The Total Non-highway Expenditure Projections shown in Table 3 are just the sums of the major expenditure categories, and the Total Non-highway Expenditures out of General Revenue Funds are the sums of the major categories of expenditures out of General Revenue Funds. These totals in comparison with the revenue projections of Table 2 indicate that the present revenue system will shortly be grossly inadequate. For example, it was mentioned above that the Total State Non-highway Revenue projections show a low and high increase of 23 percent and 51 percent in 1969-1971 in comparison to the 1959-1961 revenues. The Total State Non-highway Expenditures are projected to grow by 41 percent (low estimate) or 73 percent (high estimate) in 1969-1971 over these expenditures in *1963-1965*.

Conclusions

The extent of the inadequacies of the present revenue system of the State can best be seen by referring to Table 5 or Table 6. Table 5 shows the difference between expected revenues going into the General Revenue Fund and projected expenditures from the General Revenue Fund by biennium for each possible combination of particular revenue and expenditure projection. Negative numbers indicate that revenues will be insufficient to meet expenditure needs. Under *every* possible set of revenue and expenditure projections there will be a gap between revenues and expenditures.

By the 1969-1971 biennium if the State grows as fast as it did in the 1950's, and revenues increase as fast as they did in the 1950's, and even if expenditures are kept at their low levels, there will be a deficit of over three quarters of a billion dollars. This deficit is greater than one-third of the total State non-highway expenditures forecast for that biennium, about the same as the total combined low projections of expenditures on Public Assistance and Mental Health out of the General Revenue Fund, and is greater than the actual total yearly expenditures for non-highway purposes out of the General Revenue Fund during the 1959-1961 biennium. By the 1969-1971 biennium if the State economy grows faster than it did during the decade so that the medium revenue projections are appropriate and expenditures grow at their medium projected rate, the gap will be almost one billion dollars. This deficit will be about one-half the projected medium expenditures out of the General Revenue Fund for that biennium. Under these assumptions, the present tax structure will yield during a biennium enough to cover expenditures for only a year. A combination of high revenues and high expenditures yields even a larger gap. Even in the best of all possible worlds with low expenditures and high revenues, there will be a gap of over $350 million, which is equal to the total of projected expenditures for vocational education, public safety, public health and mental health out of the General Revenue Fund.

TABLE 5
GAPS
General Revenue Fund Revenues — Expenditures from General Revenue
(Millions of 1961 Dollars)

	63-65	65-67	67-69	69-71
I. Low Expenditures				
A. Low Revenues (2.8%)	–141.2	–369.7	–586.6	–758.8
B. Low Revenues (3.5%)	– 87.6	–287.1	–492.5	–639.8
C. Medium Revenues (4.0%)	– 64.2	–237.0	–414.1	–528.7
D. High Revenues (4.75%)	– 28.1	–159.8	–291.2	–352.1
II. Medium Expenditures				
A. Low Revenues	–248.4	–572.3	–878.7	–1157.1
B. Low Revenues	–194.8	–489.7	–784.6	–1038.1
C. Medium Revenues	–171.4	–439.6	–706.2	– 927.0
D. High Revenues	–135.3	–362.4	–583.3	– 750.4
III. High Expenditures				
A. Low Revenues	–404.8	–770.8	–1218.6	–1677.6
B. Low Revenues	–351.2	–688.2	–1124.5	–1558.6
C. Medium Revenues	–327.8	–638.1	–1046.1	–1447.5
D. High Revenues	–291.7	–560.9	– 923.2	–1270.9

TABLE 6
GAPS
Total State Non-Highway Revenues — Expenditures
(Millions of 1961 Dollars)

	63-65	65-67	67-69	69-71
I. Low Expenditures				
A. Low Revenues	–100.0	–318.1	–519.8	–663.0
B. Low Revenues	– 39.4	–224.3	–410.5	–526.6
C. Medium Revenues	– 12.9	–167.5	–323.3	–400.2
D. High Revenues	+ 27.8	– 79.9	–182.3	–197.7
II. Medium Expenditures				
A. Low Revenues	–246.3	–533.0	–826.8	–1078.8
B. Low Revenues	–185.7	–439.2	–719.5	– 944.4
C. Medium Revenues	–159.2	–382.4	–630.3	– 817.4
D. High Revenues	–118.5	–294.8	–489.3	– 615.5
III. High Expenditures				
A. Low Revenues	–381.2	–742.4	–1280.5	–1619.9
B. Low Revenues	–320.6	–648.6	–1073.2	–1483.5
C. Medium Revenues	–294.1	–591.8	– 984.0	–1356.5
D. High Revenues	–253.4	–504.2	– 843.0	–1154.6

It is obvious that the General Revenue Fund is going to be faced with intolerable burdens unless there is a drastic revision of the tax structure. Although the gaps are less for the nearer bienniums there is little reason for optimism even in the short run. As long as the State's economy lags to as great an extent as it has recently, there is every reason to expect even lower revenues than the low projections indicated for the 1963-1965 biennium. In addition any lags in the State's economy will likely result in high rather than low expenditures on public assistance. If this lag persists through the 1963-1965 biennium, therefore, there could easily be deficits amounting to over $250 million for the biennium. To overcome this size of deficit cutbacks in expenditures would be needed which would amount to the total of the low projected expenditures on vocational education, public safety, public health, and mental health. The situation could easily be intolerable as early as the coming biennium.

From Table 6 it can be seen that the projected deficits or gaps for Total Non-highway purposes are only slightly less than for the gaps out of General Revenue Funds. By the 1969-1971 biennium for the combination of low revenues and low expenditures the deficit will be about two-thirds of a billion dollars which is about one third of the total State non-highway revenues projected. Again, combinations of medium or high revenues and expenditures will lead to still greater deficits.

Another indication of the size of the projected gaps can be seen by a consideration of how much rates on existing taxes would have to be raised to overcome them. Existing rates on *all* State non-highway taxes except the ROT and related taxes would have to be more than doubled to meet even the smaller deficits. Alternatively the ROT and related taxes would have to have rate increases from four percent to six percent for the smaller gaps and to eight percent for the larger gaps. Even if either of these alternatives or a combination of them were undertaken, it is highly likely that a future Revenue Commission of 1972 would receive projections which would indicate that the future would lead to substantial gaps and that further sources of revenues would be sorely needed. The basic need of the State tax structure is for new sources of income which will yield substantial increases in revenue as the State grows. There is every indication that the types of taxes currently levied will not be able to bring in the needed revenue.

CHAPTER VIII

MUNICIPAL AND COUNTY FINANCES IN ILLINOIS

By Irving Howards

Municipal Sources of Revenue

The property tax is commonly thought of as the overwhelming revenue base available to local governments in the United States. And in 1957 the Bureau of the Census seemingly verified this view by revealing that approximately 70 percent of all revenue available to Illinois local governments from their own sources came from the property tax. However, these figures also indicated that the Illinois municipality was becoming decreasingly dependent upon the property tax deriving about 35 percent of its total revenue from this source.[1] A study of municipalities over 50,000 in population from 1946 to 1960 confirms this trend. As Table 1 indicates property tax accounted for 56.7 percent of the total revenue available to such cities in 1946. By 1960 the property tax constituted only 34.4 percent of the total revenue available to cities over 50,000 population.

The Illinois municipality is in this position in regard to the property tax because of a multitude of non-property revenue sources available. For example, one study of Illinois municipal finances listed 36 non-property revenue sources available to the city (see Table 2). As one can discern by examining this list, however, most of these revenue sources are inconsequential revenue producers for the municipality. Indeed, examination of the non-property revenue available to municipalities over 50,000 population (excluding Chicago) in Tables 3 and 4 suggests the importance of the municipal retailers occupation tax (sales tax) and at least in these cities, the sale of services provided by municipally owned utilities. These two sources of revenue provided 12.4 percent and 26.7 percent of the total revenues available to municipalities over 50,000 in population. Sales tax receipts and utility revenue combined with property tax income accounted for approximately 73.5 percent of all the revenue available to such cities. When the income from vehicle wheel tax, liquor and tavern license, parking facilities and special assessments is added one discovers that approximately 80.5 percent of all revenue available to municipalities over 50,000 in population came from these 7 sources of municipal revenue.

Expenditures of Illinois Municipalities

In common with most governments, municipalities in Illinois have experienced a spectacular increase in expenditures since World War II. As Table 5 suggests since 1946 expenditures for municipalities over 50,000 population has increased from $139,178 thousand to $553,054 thousand or

[1] *Government in Illinois*, 1957 Census (Washington: U. S. Department of Commerce, Bureau of the Census), Table 23, p. 14.

approximately 289 percent. And some of the municipalities in this population category had increases considerably higher. Further evidence of the increased expenditures and their purpose since World War II can be obtained by noting the per capita expenditures for police and fire departments for the years 1950, 1956 and 1960 as cited in Table 6. Compared to 1950 the per capita amount for police departments increased an average of 130 percent in the ten year period while fire departments costs for the same period increased approximately 110 percent. And as the table suggests some of the per capita increases were substantially greater.

However, the inflationary trends existing since 1946 must be taken into consideration if one wishes a more accurate reflection of expenditure and revenue patterns since World War II. Using 1947-1949 as the base, the Bureau of Labor Statistics determined that the dollar in 1960 was valued at 79.1 cents compared to $1.20 in 1946. Or in other words, the dollar in

TABLE 1

General Property Tax As a Source of Revenue for Municipalities Over 50,000 Population, 1946-1960, Compared to Total Revenue

(Property Tax Revenue in Thousands)

Municipality	1946	Percentage of Total Revenue	1960	Percentage of Total Revenue
Chicago	$67,356	59.9	$148,153	36.2
Aurora	577	59.0	1,361	38.4
Berwyn	362	49.7	721	26.5
Cicero	1,272	73.6	2,353	42.6
Decatur	635	50.0	1,144	28.4
E. St. Louis	1,374	71.9	1,957	38.9
Evanston	958	48.1	2,771	41.3
Joliet	340	36.8	961	26.1
Oak Park	835	60.0	1,452	39.4
Peoria	1,766	69.8	3,908	54.7
Rockford	764	50.0	2,666	31.7
Rock Island	477	48.5	1,249	31.0
Skokie	—	—	1,105	28.6
Springfield	922	62.1	1,709	18.7
Waukegan	284	55.5	1,196	33.8
		Average		Average
TOTAL	$87,922	56.7%	$172,706	34.4%

SOURCE: *Compendium of City Government Finances in 1946* (Washington: U. S. Department of Commerce, Bureau of the Census, 1958). Table II, pp. 16 25; *Compendium of City Finances in 1960* (Washington: U. S. Department of Commerce, Bureau of the Census, 1961), Table 5, pp. 18-19.

TABLE 2

Illinois Municipal Non-Property Taxing and Licensing Poweres

Tax	License and Tax	Locate and Regulate	License	Miscellaneous
1. Dogs. 2. All persons engaged in business of selling tangible personal property at retail. 3. Motor vehicle license tax. 4. Cigarette retail sales. 5. Public utilities sale of gas electricity, telephone messages.	1. Hackmen, draymen, omnibus drivers, carters, cabmen, porters, expressmen, and others in like occupations. 2. Runners for cabs, buses, railroads, ships, hotels, public houses and other similar businesses. 3. All vehicles conveying loads within municipalities. 4. Hawkers, peddlers, pawnbrokers, itinerant merchants, transient vendors of merchandise, theatricals and other exhibitions, shows and amusements; all places for eating or amusement. 5. All athletic contests and exhibitions carried on for gain.	1. Use and construction of: 1. Packing houses. 2. Candle, fertilizer and soap factories. 3. Tanneries. 4. Places where any beverage or food for human consumption is sold. 5. Breweries. 6. Distilleries. 7. Stables. 8. Blacksmith shop. 9. Foundries. 10. Machine shops. 11. Garages. 12. Parking lots. 13. Laundries. 14. Bathing beaches. 2. Hospitals. 3. Water craft. 4. Places where any beverage or food for human consumption is sold.	1. Local retailers of alcoholic beverages (called a fee). 2. Street advertising. 3. Steam engine operators. 4. Elevator operators. 5. Construction of: 1. Breweries. 2. Distilleries. 3. Stables. 4. Blacksmith shop. 5. Foundries. 6. Machine shops. 7. Garages. 8. Parking lots. 9. Laundries. 10. Bathing beaches.	1. Establish and regulate cemeteries. 2. Provide for and regulate inspection, weighing, measuring of brick, lumber, firewood, coal, hay and any article of merchandise of same kind. 3. Regulate and prevent storage of oil and explosives.

TABLE 2 (Continued)

Tax	License and Tax	Locate and Regulate	License	Miscelaneous
	6. Pinball, bowling alleys, billiard, bagatelle, pigeon-hole, pool or any other tables or implements kept for a similar purpose in any place of public resort. 7. Auctioneers, private detectives, money changers, bankers, brokers, barbers and keepers or owners of lumber yards, lumber storehouses, livery stables, public scales, ice cream parlors, coffee houses, florists, detective agencies, barber shops. 8. All places of business of dealers in junk, rags and any secondhand articles whatsoever.	5. Sanitaria. 6. Undertaking establishments.		4. Fees: 1. Foreign fire insurance companies. 2. Registration fee of $25 annually on electrical contractors. 5. Permits to mine oil and gas and proper remuneration therefrom. 6. Regulate use of streets. 7. Regulate openings in streets and other municipal property for laying, building, repairing and removing of gas or water mains and pipes, or sewers, tunnels and drains. 8. Commutation of street labor for $ .75 per day. 9. Permit required for masonry work in cities over 150,000. 10. Provide for and regulate inspection of all food for human consumption and tobacco.

SOURCE: Jack Isakoff, Gilbert Y. Steiner, June E. Cabe, *Illinois Municipal Revenue*, Second Edition, Revised 1958 (Urbana: Institute of Government and Public Affairs, University of Illinois), pp. 49-50.

TABLE 3

Total Income from Selected Non-Property Taxes and Licenses for Municipalities Over 50,000 Population, 1960
(In Thousands)

Municipality	Sales Tax	Vehicle Wheel Tax	Liquor and Tavern License	Parking Facility	Utilities	Special Assessments
Aurora	$ 524	$ 76	$ 57	$151	$ 693	$ 56
Berwyn	425	128	67	40	706	33
Chicago	22,627	—	—	—	40,128	5,742
Cicero	486	119	168	64	1,395	—
Decatur	644	—	77	202	1,223	—
E. St. Louis	497	1,051	175	42	—	—
Evanston	568	442	222	274	1,372	182
Joliet	625	70	134	99	1,196	181
Oak Park	556	188	—	187	921	—
Peoria	991	—	121	135	—	—
Rockford	1,052	309	185	365	1,481	433
Rock Island	302	81	103	107	912	—
Skokie	546	257	37	25	1,043	200
Springfield	771	—	124	212	5,120	—
Waukegan	488	85	90	102	723	205

SOURCE: *Municipal Finance in Illinois* (Springfield: Auditor of Public Accounts, 1960), Table 5, pp. 88-95; *Compendium of City Government Finances in 1960* (Washington: Department of Commerce, Bureau of Census, 1961), Table 5, p 18.

TABLE 4

Selected Revenue Other Than the General Property Tax for Municipalities Over 50,000 Population As a Percentage of Total Revenue, 1960
(Excluding Chicago)

Municipality	Sales Tax	Vehicle Wheel Tax	Liquor and Tavern License	Parking Facility	Utilities	Special Assessments
Aurora	14.8%	2.0%	1.6%	4.3%	19.6%	1.6%
Berwyn	15.6	4.7	2.5	1.5	25.9	1.2
Cicero	8.8	2.2	3.0	1.2	25.2	—
Decatur	16.0	—	1.9	5.0	30.4	—
E. St. Louis	9.9	20.9	3.5	.8	—	—
Evanston	8.5	6.6	3.3	4.1	20.4	2.7
Joliet	17.0	1.9	3.6	2.7	32.5	4.9
Oak Park	13.3	4.5	—	4.5	22.0	—
Peoria	13.9	—	1.7	1.9	—	—
Rockford	12.5	3.7	2.2	4.3	17.6	5.2
Rock Island	7.5	2.0	2.6	2.7	22.7	—
Skokie	14.1	6.7	1.0	.6	27.0	5.2
Springfield	8.4	—	1.4	2.3	56.0	—
Waukegan	13.8	2.4	2.5	2.9	20.4	5.8
AVERAGE	12.4%	5.1%	2.4%	2.8%	26.7%	3.8%

SOURCE: As computed from figures obtained from *Municipal Finance in Illinois* (Springfield: Auditor of Public Accounts, 1960), Table 5, pp. 88-95 and *Compendium of City Finances in 1960* (Washington: U. S. Department of Commerce, Bureau of the Census, 1961), Table 5, pp. 18-19.

1960 was approximately 65.9 percent of the value of the dollar in 1946.[2] Taking this into consideration one notes in Tables 5 and 7 that expenditures actually increased from $139,178 thousand in 1946 to $367,059 thousand in 1960 or approximately 163 percent. Revenue, measured by real dollar value increased from $130,366 thousand to $314,065 thousand or approximately 141 percent.

TABLE 5

Total Expenditures of Illinois Municipalities Over 50,000 Population — 1946-1960 — According to 1960 Census

Expenditures in Thousands

Municipalities	1946	1960	As Measured by Consumer Price Index 1960
Chicago	$122,251	$487,145	$321,029
Aurora	857	3,641	2,399
Berwyn	653	2,967	1,955
Cicero	1,675	5,161	3,401
Decatur	1,095	3,255	2,145
E. St. Louis	1,332	4,091	2,696
Evanston	1,825	6,018	3,966
Joliet	719	3,687	2,430
Oak Park	1,362	4,161	2,742
Peoria	2,492	6,440	4,244
Rock Island	1,062	4,016	2,647
Rockford	1,813	8,640	5,694
Skokie	—	3,938	6,862
Springfield	1,514	10,412	2,595
Waukegan	528	3,420	2,254
TOTAL	$139,178	$553,054	$367,059

SOURCE: *Compendium of City Government Finances in 1946* (Washington: U. S. Department of Commerce, Bureau of the Census, 1948), Table 12, p. 26; *Compendium of City Government Finances in 1960* (Washington: U. S. Department of Commerce, Bureau of the Census, 1961), Table 5, pp. 18-19.

County Sources of Revenue

An examination of the revenue sources available to the county confirms the traditional view that the county continues to depend heavily upon the property tax as its major source of locally collected revenue. Examination of the revenue sources available to 23 counties from 1945 to 1957 (the latest year that reliable county financial figures are available) detailed in Tables 8 through 11 indicates that 71 percent of all revenues raised locally by the county comes from the property tax.[3] And it is significant to note that this pat-

[2] *Monthly Labor Review*, Statistical Supplement, Vol. 83, July-December, 1960 (Washington: U. S. Department of Labor), Table IV-I, p. 19; *Monthly Labor Review*, Vol. 78, 1955 (Washington: U. S. Department of Labor), p. 144.

[3] The 23 counties included were selected because of the existence of comparable data. No 1945 figures were available for Kankakee County.

tern of dependency upon the property tax held consistently at this percentage throughout the 12 year period. Implicit in this chronic dependence upon the property tax is the limited local tax base available to the county. Other than the property tax, charges and miscellaneous revenue (consisting mainly of fees collected by the various county offices for performance of duties) constituted the major source of locally collected revenue during this period.

A look at the total revenue available to the county still emphasizes the importance of the property tax. Thus Table 10 indicates that the property tax constituted 54 percent of all the revenue available to the county. But a view of total revenue also reveals another point of major significance, i.e., that approximately 24 percent of the counties' total revenue during this

TABLE 6

Per Capita Expenditures for Selected Illinois Municipalities For Police and Fire Departments, 1950, 1956, 1960

Municipality	1950	1956	1960	Increase As Compared to 1950
Chicago				
Police	$4.56	$14.43	$21.35	366%
Fire	3.63	6.63	8.70	140
Peoria				
Police	4.56	7.59	11.20	146
Fire	4.76	7.71	9.30	96
Rockford				
Police	4.36	6.23	7.47	71
Fire	4.38	6.90	7.23	65
Springfield				
Police	4.65	5.41	7.10	53
Fire	3.57	5.23	7.94	123
Oak Park				
Police	4.78	7.80	9.25	94
Fire	4.40	7.05	9.36	113
Decatur				
Police	2.68	4.72	5.12	91
Fire	2.77	4.76	5.49	98
Aurora				
Police	3.00	7.31	6.92	131
Fire	3.13	6.00	7.31	134

SOURCE: *Compendium of City Government Finances in 1950* (Washington: Department of Commerce, Bureau of the Census, 1951), p. iii, Table 13, p. 37; *Compendium of City Government Finances in 1956* (Washington: Department of Commerce, Bureau of the Census, 1957), Table 16, pp. 50-70; *Compendium of City Government Finances in 1960* (Washington: Department of Commerce, Bureau of the Census, 1961), Table 6, pp. 46-47.

period came from inter-governmental revenue, with all but 2 percent of this amount in the form of state aid.

The revenue base of the county was altered somewhat when the 1959 General Assembly approved a county one-half cent retail occupation tax for the unincorporated areas.[4] As of July 1962, 66 counties were levying this tax.[5] The total amounts received by the 18 of the original 23 counties using the tax varied in fiscal 1961 from $614,000 in DuPage to $9,000 in Cass.[6] A determination of the percentage that county retail occupation tax

TABLE 7

Total Revenues of Illinois Municipalities Over 50,000 Population, 1946-1960

(In Thousands)

Municipality	1946	1960	1960 Measured By Consumers Price Index
Chicago	$112,405	$408,864	$269,442
Aurora	978	3,540	2,333
Berwyn	729	2,724	1,795
Cicero	1,729	5,528	3,643
Decatur	1,271	4,028	2,655
E. St. Louis	1,910	5,027	3,313
Evanston	1,993	6,717	4,427
Joliet	923	3,682	2,427
Oak Park	1,391	4,193	2,763
Peoria	2,529	7,146	4,709
Rockford	1,528	8,417	5,547
Rock Island	983	4,023	2,651
Skokie*	—	—	—
Springfield	1,485	9,147	6,028
Waukegan	512	3,539	2,332
TOTAL	$130,366	$476,578	$314,065

SOURCE: *Compendium of City Government Finances in 1946* (Washington: U. S. Department of Commerce, Bureau of the Census, 1948), Table 2, p. 16; *Compendium of City Government Finances in 1960* (Washington: Department of Commerce, Bureau of the Census, 1961), Table 5, pp. 18-19.
*Skokie revenue is not included because of the unavailability of comparable figures.

receipts was of total revenue or locally collected revenue for fiscal 1961 in these 18 counties was impossible since expenditure and revenue figures were not available. However, some general impressions of the importance of the retail occupation tax for the county (more commonly referred to as the county sales tax) can be obtained by using 1961 county sales tax income and comparing it to 1957 total revenue and total locally collected revenue.

[4] *Illinois Revised Statutes* (1961), Chapter 34, Section 409.1.
[5] As determined from the July 1962 compilation of such receipts by the State Department of Revenue.
[6] See Table 12.

Using this procedure Table 12 reveals that the retail occupation tax receipts varied from .5 percent of total revenue for Cook to 19 percent for DuPage county. The county sales tax for locally collected revenue varied from .7 percent for Cook to 21 percent for DuPage. An average of the 18 counties involved indicates that they would have received 6 percent of their total revenue from this source and 7 percent of all their locally collected revenue. One can safely assume that a similar comparison using 1961 total revenue and total locally collected revenue would diminish to some extent these percentage figures as derived from comparing 1961 retail tax receipts to 1957 county revenue. Nevertheless, it seems quite clear that the importance of the property tax to the county tax base has not been significantly altered

TABLE 8

Total Revenue of Selected Illinois Counties, 1945
(In Thousands)

County	Taxes			Intergovernmental Revenue	Charges and Misc. Revenue	
	Total	Property	Other		Current Charges	Other
Cook	$22,836	$22,573	$263	$3,949	$7,057	$61
Brown	35	35	—	—	—	—
Cass	64	64	—	59	36	—
Champaign	329	324	5	9	—	65
DuPage	391	357	34	126	372	48
Edgar	78	78	—	2	—	1
Edwards	39	39	—	1	16	15
Henry	144	144	—	26	35	2
Jackson	132	125	7	55	19	8
Kane	343	327	16	207	356	16
Knox	173	161	12	64	117	4
Lake	534	460	74	259	165	1
LaSalle	613	594	19	96	212	3
McLean	296	287	9	95	161	3
Macoupin	258	257	1	93	19	2
Madison	474	463	11	43	47	—
Menard	72	72	—	9	15	—
Peoria	463	442	—	21	202	4
Rock Island	321	311	10	139	62	3
Tazewell	190	175	15	81	115	11
Whiteside	241	236	5	17	104	—
Winnebago	345	328	17	153	450	27

SOURCE: *County Finances, 1945* (Washington: U. S. Department of Commerce, Bureau of the Census, 1947), Table 13, pp. 23-24.

(except perhaps in the case of rapidly growing urban counties similar to DuPage) even though county sales tax income may make an important contribution to the financial solvency of a county.

Expenditures of Illinois Counties

As was the pattern with Illinois municipalities, expenditures for the 23 counties investigated increased greatly after World War II. Table 13 shows the total expenditures for the 23 counties in 1957 was approximately $135,437 thousand compared to $42,695 thousand in 1945 or an apparent increase of 217 percent for this 12 year period. During this same period,

TABLE 9

Total Revenue of Selected Illinois Counties, 1957
(In Thousands)

	Taxes			Intergovernmental Revenue		Charges and Misc. Revenue	
County	Total	Property	Other	Total	State	Current Charges	Other
Cook	$45,967	$44,543	$1,424	$32,909	$30,851	$20,526	$3,480
Brown	111	111	—	74	35	30	4
Cass	140	136	4	78	78	17	6
Champaign	877	858	19	357	250	406	27
DuPage	2,223	1,992	231	324	315	611	36
Edgar	254	250	4	119	119	42	10
Edwards	93	91	2	23	23	27	3
Henry	442	433	9	202	182	195	20
Jackson	345	338	7	149	149	43	—
Kane	1,190	1,102	88	458	392	354	91
Kankakee	733	693	40	258	258	93	25
Knox	635	612	23	205	205	323	42
Lake	2,184	1,902	282	1,181	924	373	63
LaSalle	1,036	990	46	354	354	254	23
MacLean	1,623	1,616	7	224	216	90	16
Macoupin	308	297	11	134	115	162	4
Madison	1,765	1,705	60	964	934	408	56
Menard	131	130	1	66	62	104	6
Peoria	1,122	1,052	70	673	629	350	101
Rock Island	1,567	1,546	21	683	609	358	143
Tazewell	865	848	17	356	356	297	29
Whiteside	500	319	181	309	292	106	19
Winnebago	1,217	1,186	31	649	547	688	54

SOURCE: *Government in Illinois,* 1957 Census of Governments (Washington: U. S. Department of Commerce, Bureau of the Census), Table 38, pp. 33-40.

according to Table 14 revenue increased from $43,910 thousand to $139,822 thousand or approximately 218 percent.

However, a more accurate picture can be obtained regarding both expenditure and revenue by once more taking into account the changing

TABLE 10

Revenue of Selected Illinois Counties As a Percentage of Total 1957 Revenue

County	Taxes			Intergovernmental Revenue		Charges and Misc. Revenue
	Total	Property	Other	Total	State	
Cook	43%	42%	1	31%	29%	23%
Brown	51	51	—	34	16	16
Cass	58	56	2	32	32	10
Champaign	53	52	1	22	15	26
DuPage	70	62	8	10	9	20
Edgar	60	59	1	28	28	12
Edwards	64	63	1	16	16	21
Henry	52	51	1	24	21	25
Jackson	64	63	1	28	28	8
Kane	57	53	4	22	19	21
Kankakee	66	62	4	23	23	11
Knox	53	51	2	17	17	30
Lake	57	50	7	31	24	12
LaSalle	62	59	3	21	21	17
McLean	83	82	1	12	11	5
Macoupin	51	49	2	22	19	27
Madison	55	53	2	30	29	15
Menard	43	43	—	22	21	36
Peoria	50	47	3	30	28	20
Rock Island	57	56	1	25	22	18
Tazewell	56	55	1	23	23	21
Whiteside	54	34	200	33	31	13
Winnebago	47	46	1	25	21	29
AVERAGE	57%	54%	3%	24%	22%	19%

SOURCE: As derived from *Government in Illinois*, 1957 Census of Governments (Washington: U. S. Department of Commerce, Bureau of the Census), Table 38, pp. 33-40.

value of the dollar from 1945 to 1957. Again using 1947-1949 as the base years the Bureau of Labor Statistics has determined that the dollar in 1957 was worth 83 cents compared to $1.30 in 1945. In short, then the 1957 dollar was approximately 62 percent of the 1945 dollar.[7] Using this as a guide,

[7] U. S. Department of Labor, *Monthly Labor Review*, Vol. 81, (Washington: January-June), Table D, p. 467.

Table 13 indicates that expenditures for 1957 in terms of real dollar value was about $83,976 thousand compared to $42,695 thousand in 1945. This represents a 97 percent increase in expenditures. Taking into account the real value of the dollar Table 14 reveals that revenue increase from $43,910 thousand in 1945 to $86,690 thousand in 1957, also an increase of approximately 97 percent.

An Evaluation of Municipal and County Finances

The statistical examination of municipal revenue and expenditures, then, confirms the fact that the property tax is becoming less important to the municipality because of the growth of such tax sources as the municipal

TABLE 11

Property Tax As a Percentage of Locally Raised Revenue, 1945-1957

County	1945	1957
Cook	75%	64%
Brown	100	77
Cass	64	83
Champaign	82	66
DuPage	44	69
Edgar	99	82
Edwards	56	74
Henry	80	66
Jackson	79	87
Kane	46	67
Kankakee	—	81
Knox	55	61
Lake	66	73
LaSalle	72	76
McLean	62	94
Macoupin	92	63
Madison	89	77
Menard	83	54
Peoria	66	67
Rock Island	81	75
Tazewell	55	71
Whiteside	68	51
Winnebago	40	61
AVERAGE	71%	71%

SOURCE: *County Finances, 1945* (Washington: U. S. Department of Commerce, Bureau of the Census, 1947), Table 13, pp. 23-24 and *Government in Illinois*, 1957 Census of Governments (Washington: U. S. Department of Commerce, Bureau of the Census), Table 38, pp. 33-40.

retailers occupation tax, the sales of municipal utility services and the other varied tax sources available. It also suggests that both expenditures and revenues have increased significantly since 1946. The county, on the other hand seems closely bound to a dependence upon the property tax as the primary source of locally raised revenue and indeed as the major source of all its revenue.

Three additional items of note were discovered in regard to county finances. First, a surprisingly large percentage of locally raised revenue is derived from charges and miscellaneous services. As noted previously this suggests the importance of the fee system, a long criticized county fiscal practice, to the county under its presently constituted tax base. Secondly, one noted the importance of intergovernmental revenue as a revenue source

TABLE 12

County Retailers' Occupation Tax July 1961 Through June 1962 for Selected Illinois Counties*

Counties	Total (In Thousands)	Retail Occup. Tax Compared to 1957 Total Revenue (Percentage)	Retail Occup. Tax Compared to Total 1957 Locally Collected Revenue (Percentage)
Cook	$ 477	.5%	.7%
Cass	9	4	6
Champaign	67	4	5
DuPage	614	19	21
Edgar	16	4	5
Jackson	28	5	7
Kane	129	6	8
Kankakee	84	8	10
Knox	44	4	4
Lake	158	4	6
McLean	63	3	3.6
Macoupin	27	5	6
Madison	157	5	7
Menard	12	4	5
Peoria	258	12	16
Rock Island	49	2	2
Tazewell	62	4	5
Whiteside	47	5	8
TOTAL	$2,301	6 %	7 %
		(Averages)	

*Retail Occupation receipts were derived from monthly compilation of such receipts by the State Department of Revenue for fiscal 1961. Percentages were computed on the basis of total revenue and total locally collected revenue as cited in *Government in Illinois*, 1957 Census of Government ments (Washington: U. S. Department of Commerce, Bureau of the Census), Table 38, pp. 33-40.

available to the county. Intergovernmental revenue is of such magnitude because of the county's traditional role for the state in such areas as general assistance, highways, and public health. Yet one must not ignore the possibility that increasing amounts of state-aid are probably necessary because of the county's inability to raise adequate revenue for its portion of the cost of supplying the services in question. Third, the county retail occupation tax passed by the 1959 General Assembly was of obvious aid in broadening the tax base of the county and providing the county with crucially needed revenue. And as is implied from the sales tax receipts for DuPage county, the tax will apparently constitute an important percentage of total revenue and total locally collected revenue for the rapidly growing metropolitan

TABLE 13
Total Expenditures of Selected Counties 1945-1957
(In Thousands)

County	1945	1957	1957 Taking Account of Consumer Price Index
Cook	$32,771	$106,577	$66,078
Brown	33	124	77
Cass	152	250	155
Champaign	418	1,216	754
DuPage	656	2,225	1,380
Edgar	75	398	247
Edwards	51	156	97
Henry	243	854	530
Jackson	203	443	275
Kane	639	1,133	703
Kankakee	341	1,133	703
Knox	338	1,185	735
Lake	1,012	3,105	1,925
LaSalle	777	1,205	747
McLean	560	1,535	952
Macoupin	415	789	489
Madison	616	2,758	1,710
Menard	104	283	176
Peoria	932	2,101	1,303
Rock Island	461	2,563	1,589
Tazewell	346	1,699	1,053
Whiteside	310	925	574
Winnebago	992	2,780	1,724
TOTALS	$42,695	$135,437	$83,976

SOURCE: U. S. Bureau of the Census, *County Finances in 1945* (1947), Table 14, pp. 42-43; U. S. Bureau of the Census, *Government in Illinois* (1957), Table 38, pp. 33-40.

county. But generally speaking, the county retail sales tax at its presently constituted rate does little to detract from the importance of the property tax as the major source of county revenue.

It is important to keep in mind that the statistical examination of municipal and county revenue and expenditure is not of particular aid in revealing the specifics concerning the fiscal condition of either the municipality or the county. As noted, expenditure increased for municipalities since 1946 at approximately 163 percent compared to an increase in revenue of

TABLE 14

Total Revenue Increase of Selected Illinois Counties, 1957 Compared to 1945
(In Thousands)

County	Total 1945	Total 1957	Total 1957 Measured by Consumers Price Index
Cook	$33,903	$106,511	$66,037
Brown	35	219	136
Cass	159	241	149
Champaign	403	1,667	1,034
DuPage	937	3,194	1,980
Edgar	81	426	264
Edwards	71	145	90
Henry	207	858	532
Jackson	214	537	333
Kane	922	2.093	1.298
Kankakee	—	1,110	688
Knox	358	1,205	747
Lake	959	3,802	2.357
LaSalle	924	1,667	1,033
McLean	555	1,953	1,211
Macoupin	372	608	377
Madison	564	3,193	1,980
Menard	96	307	190
Peoria	891	2,247	1,393
Rock Island	525	2,750	1,705
Tazewell	397	1,548	960
Whiteside	362	935	580
Winnebago	975	2,606	1,616
TOTALS	$43,910	$139,822	$86,690

SOURCE: *County Finances, 1945* (Washington: U. S. Department of Commerce, Bureau of the Census, 1947), Table 13, pp. 23-24 and *Government in Illinois*, 1957 Census of Governments (Washington: U. S. Department of Commerce, Bureau of the Census), Table 38, pp. 33-40.

TABLE 15

Maximum Tax Extension for County Corporate Fund in 1960 Compared to 1945

County	1960 Maximum Extension With Permissible County Corporate Rate	1945 Maximum Extension With Permissible County Corporate Rate	1960 Maximum Extension Taking Into Account Consumers Price Index
Adams	$295,323	$171,181	$179,704
Alexander	38,362	32,993	23,648
Boone	88,780	48,127	54,023
Bureau	130,623	88,338	79,484
Carroll	78,269	37,445	47,627
Cass	61,101	37,845	37,180
Champaign	250,322	145,554	152,321
Christian	151,050	84,905	91,914
Clark	37,025	23,938	23,530
Clay	42,064	30,206	25,596
Clinton	75,681	47,128	46,052
Coles	94,515	57,624	57,512
Crawford	58,637	33,116	35,681
DeKalb	176,442	100,935	107,365
DeWitt	72,016	49,406	43,822
Douglas	88,175	52,965	53,655
DuPage	534,298	182,323	325,120
Edgar	74,907	59,528	45,581
Effingham	61,907	38,124	37,670
Fayette	92,163	71,274	56,081
Ford	73,825	49,825	44,923
Fulton	150,628	96,384	91,657
Greene	59,065	40,985	35,941
Grundy	79,362	51,213	48,292
Hancock	112,263	75,303	68,312
Henry	185,479	122,818	112,864
Iroquois	142,159	109,658	86,504
Jackson	68,900	37,783	41,926
Jefferson	57,731	45,842	35,129
Jersey	42,701	24,905	25,984
Jo Daviess	67,589	50,658	41,128

TABLE 15 (Continued)

County	1960 Maximum Extension With Permissible County Corporate Rate	1945 Maximum Extension With Permissible County Corporate Rate	1960 Maximum Extension Taking Into Account Consumers Price Index
Kane	451.165	232,995	274.534
Kankakee	202,169	102,314	123,020
Knox	236,459	149,533	143,885
Lake	488,798	233,048	297,434
LaSalle	355,403	233,837	216,263
Lawrence	53,401	28,710	32,495
Lee	160,885	105,938	97,899
Livingston	203.109	116,326	123,592
Logan	168,205	95,790	102,353
McDonough	103.194	70,688	62,794
McHenry	242,120	99,050	147,330
McLean	274,890	178,278	167,271
Macon	291,978	168,409	177,649
Macoupin	91,120	63,827	55,447
Madison	452,612	251,885	275,414
Marion	102,518	75,283	62,382
Mason	89,750	44,944	54,613
Mercer	65,313	47,513	39,743
Montgomery	87,249	62,730	53,091
Morgan	152,213	79,771	92,621
Ogle	142,711	97,519	86,840
Peoria	470,619	293,922	286,372
Perry	50,540	36,147	30,754
Pike	58,543	40,348	35,623
Randolph	70,496	45,977	42,897
Richland	43,129	32,027	26,244
Rock Island	341,466	184,173	207,782
St. Clair	596,461	362,820	342,947
Saline	36,890	29,902	22,448
Sangamon	365,871	221,358	222,633
Shelby	90,503	56,440	55,071
Stephenson	145,719	97,342	88,670
Tazewell	293,211	134,340	178,419

TABLE 15 (Continued)

County	1960 Maximum Extension With Permissible County Corporate Rate	1945 Maximum Extension With Permissible County Corporate Rate	1960 Maximum Extension Taking Into Account Consumers Price Index
Union	44,082	26,422	24,998
Vermilion	243,399	161,896	148,108
Warren	89,828	64,093	54,660
Wayne	49,603	38,008	30,184
White	35,653	30,156	21,695
Whiteside	173,398	98,498	105.513
Will	379,415	205,226	230,874
Williamson	61,487	37,935	37,415
Winnebago	461,002	217,793	280,520
Woodford	83,043	55,551	50,532

SOURCE: *The maximum extension for 1945 was computed by multiplying the maximum county corporate rate then permissible against the assessed valuation of the county involved. The maximum extension for 1960 was determined in the same fashion as well as from an abstract of current taxes extended in each county in 1960 supplied by the State Department of Revenue. This table is part of a study *Property Tax Rate Limits in Illinois, Their Effect on Local Government Operation,* written by the author for the 1962-1963 Illinois Revenue Laws Commission.
†*Monthly Labor Review,* Statistical Supplement, Vol. 83, July-December 1960 (Washington: U. S. Department of Labor), Table II-1, p. 19 and *Monthly Labor Review,* Statistical Supplement, Vol. 78, 1955 (Washington: U. S. Department of Labor), p. 744 using 1947-1949 as the base the Bureau of Labor Statistics indicates that the dollar in 1960 was worth 79.1 cents compaired to $1.30 in 1945. In short, the 1960 dollar was approximately 60.85 percent the value of the dollar in 1945. This percentage was applied against the 1960 maximum extension.

approximately 141 percent. Counties, apparently increased their expenditures and revenues approximately 97 percent since 1945. The 22 percent imbalance in revenue for the municipalities does not necessarily imply, however, that municipalities are in dire fiscal condition since most of this difference can probably be accounted for in the municipal issuance of revenue and general obligation bonds with an allocation of revenue to retire such issues spread over many years. The county balance between revenue and expenditure, on the other hand does not necessarily suggest that the county has no need for either additional expenditures or revenue. (Although it does of course indicate that neither county expenditures nor revenue increases have approximated the municipal increases.) The figures simply suggest the more limited prerogatives available to the county to issue bonds and the consequent necessity of the county to be more concerned with matching current income with expenditures. In short then, such expenditures and revenue figures are simply a reflection of the principle of balanced budget making.

A more detailed picture of the actual fiscal situation prevailing among municipal and county government then must await either intensive field

investigations or a measurement of increases in services, costs of such services and future probable needs.[8] Some preliminary work in this direction recently completed shows that expenditures for police, fire protection, sewage, sanitation, parks and recreation are ". . . much higher in both the Northeastern and Downstate Metropolitan counties and highest of all in Cook County"; that ". . . local government expenditure represents a larger portion of personal income in Southern and Agricultural counties than it does in the urban counties"; and that ". . . Southern counties receive one-third of their revenue from intergovernmental sources as compared with only 14.6 percent received from this source by the Northeastern Metropolitan counties."[9] Such studies and the results thereof will be extremely useful in providing more information upon which one can judge the complete fiscal condition of Illinois local governments.

In the interim, however, the existing data if used cautiously can suggest some facts about the specific fiscal condition of the Illinois municipality and county. For example, per capita expenditures have apparently increased for some of the traditional services offered by the municipality, if the trend suggested by police and fire department expenditures can be generally applied. (See Table 6). Secondly as Table 15 reveals, income available for the

TABLE 16

Illinois Cities (Except Chicago) With At Least One-Year Experience With the 5% Utilities Tax — January 1962

City	Rate	1960 Income	Annual Per Capita	1961 Revenue	Annual Per Capita
Cairo	5%	$ 61,411	$6.57	$ 62,357.72	$6.67
Carmi	5			30,344.27*	—.
East St. Louis	5			479,444.28†	5.87
East Moline	5	112,000	6.69	117,000.00	6.99
Zion	5			68,642.72‡	5.75

*Eight-month period, May 1961 through January 1962.
†Last quarter of 1960; first three quarters if 1961.
‡Fiscal year May 1, 1960-April 30, 1961.

county corporate fund—used by counties for salaries, administration, and as general "catch-all"—has decreased from 1945 to 1960 for 46 counties; with only Lake, Winnebago and DuPage registering significant increases for the county corporate fund. A matter of fundamental importance then (if this does correctly imply that the municipality and county are having difficulty allocating sufficient revenue for traditional services), is to discover means of easing this suggested local government dilemma.

[8] See for example, Henry J. Schmandt and G. Ross Stephens, "Measuring Municipal Output," *National Tax Journal* (December 1960); Harvey Shapiro, "Measuring Local Government Output, A Comment," *National Tax Journal* (December 1961); Glenn W. Fisher, "Determinants of State and Local Government Expenditures: A Preliminary Analysis," *National Tax Journal* (December 1961).

[9] Glenn W. Fisher, "Illinois Local Government Finance: Geographic Variations," *Illinois Government*, No. 13, April 1962 (Urbana: Institute of Government and Public Affairs, University of Illinois).

CHAPTER IX

TAX INCIDENCE

By Vernon G. Morrison*

In our relatively free market economy the weight of a tax may not stay with the initial taxpayer; instead, it may shift elsewhere, in varying degrees. Whereas law establishes the initial money "impact" of a tax, economic forces then take over and, through the price system, further determine where and what the incidence and effects of the tax shall be. Unless otherwise specifically indicated, the concept of "incidence" employed in this paper relates to tax-caused relinquishment of purchasing power for which the economic process yields no further money reimbursement. "Effects" of a tax, where additionally sketched, relate to adjustment and alteration in the complexes of supply and demand as the economy moves from one equilibrium to another because of the tax.

Tax "burden," occasionally treated as synonomous with tax incidence, is separately distinguished here. Burden, because of its ethical connotation, not only involves but goes beyond incidence, to measure weight of a tax in relation to some chosen significant variable, such as size or character of taxpayer income, property ownership, family size *et cetera*. This paper deals mainly with tax shifting and incidence.

On occasion, broad assumptions are made as to dominant tax incidence, to characterize an entire tax system. For example, a report to the citizenry of the State of Illinois during Governor Stevenson's administration suggests the following orientation:[1]

"What you *spent* largely determined your Illinois STATE tax bill. (1950: Consumption 62%, Motor Fuel, 14%). (1961: 65% and 17%).

"What you *owned* largely determined your local tax bill. (1950: Property 89%). (1961: 88%).

"What you *earned* largely determined your Federal tax bill. (1950: Personal Income 50%). (1961: 53%).

A concomitant area of concern is the incidence of benefits of government services. A few have sought to measure this, in relation to size of individual income. Some of this material will be presented later. The major showing is that for most taxes and benefits the measure of each is greater relative to the lower than to the higher incomes.

Forward, Backward, or No Tax Shifting. It is possible that no shifting may occur, in which case the incidence of a tax is at the point of legal impact. If tax shifting does take place, the direction may be backward, in that the initial taxpayer pays less than otherwise for goods and services he *buys*. Or

*The author is Associate Professor of Economics at Southern Illinois University.

[1] *Services and Costs: 1950;* A Report on Your Illinois State Government: Where the Money Came From and What it Bought, p. 32. George W. Mitchell, Director, Department of Finance, Springfield, Illinois, March 1951. Data for 1961 are derived from *Governmental Finances in 1961*, Bureau of the Census, United States Department of Commerce, G-GF61-No. 2, October 26, 1962

the shifting may be forward, in that he obtains higher prices than otherwise for the goods and services he *sells*. It is a consensus that, if a tax is to be shifted, price must be the vehicle to carry it to new destinations. Also, prices must change relative to one another; whereas a change in the *general* price level may not activate tax shifting. For certain types of taxes, such as those on polls and personal income, price is not available to serve this function. Unique conditions of demand and supply may greatly inhibit price transmission of a tax; in other circumstances a tax may be widely reallocated through a sequence of transactions. The same tax may at one time be shifted backward, in a buyers' market, and at another time be shifted forward, in a sellers' market. Jurisdictional scope of the taxing government is usually significant in that tax shifting tends to be easier where the tax is widely and uniformly levied. Whether a legislative step inaugurates a new tax or revises an old one, and whether this takes place under balanced or unbalanced, stable or changing government budget conditions, can differently affect the pattern and direction of tax incidence, in state as well as federal taxation.

Incidence as an Area of Concern. Because taxes, unlike prices, are viewed as coercive, they quickly draw attention to the problem of achieving "fair" and "equitable" treatment of the taxyayer. When, because of tax shifting, identification of the ultimate taxpayer(s) becomes uncertain, the gravity of the problem mounts. Concern further deepens with the thought that not alone the taxes but also the government expenditures they finance can greatly affect the course and strength of government and the economy, both in the aggregate, and as to the economic position of firms and individuals.

The total process is so tenuous and its appraisal so dependent upon value judgments as both to make general identification of ultimate tax incidence difficult and precise measurement of it impossible. Thus it is not surprising that much of the considerable study of tax shifting and incidence has made use of "model" building and deductive logic. Empirical exploration, although growing and useful, nevertheless encounters severe limitations and continues to be highly tentative. Much of the statistical material that appears to touch upon this subject deals mostly with the burden of taxes on members of various income-size and other groups, and gives only minimal attention to the processes of shifting of particular taxes.

Incidence, and the Elusive Goal of Fair Treatment

Even were it possible to trace tax shifting and incidence with much precision and clarity, how might this prove useful? How may a citizen employ such information, whatever his capacity: as taxpayer, as a recipient of government service, as tax administrator, as legislator? Is there any yardstick for fair tax treatment? Other papers in this series suggest guides which, if used with indicated caution, should prove helpful. Although these will not be cataloged here, a very brief critique of some leading ethical

views of long standing appears desirable, if only to identify a point of view.

Most government services are provided without price, the market system being deemed inadequate on a purely voluntary, contractual basis to supply them as, when, and where the public may desire. Having become government services they rapidly lose any market gauge of price or value they formerly may have possessed. Identification of individual benefit may be possible but measurement of it becomes obscure.

It is a prevalent view that much of the benefit of government services accrues to persons in the lower income groups. Because state and local tax systems tend to be regressive in incidence relative to individual income distribution, it would appear that their taxes relate in a general way to benefit. Nevertheless, it is most difficult to construct a particular tax to accord strictly with the benefit derivable from a related governmental service. To tax according to an individual's *total* benefit appears undesirable even were it possible to measure it. Certainly benefits in the market place are not priced this way; instead, the "law of one price" largely operates there. Preferably, therefore, such a tax measure should be drawn in terms of "marginal" benefit. There is no clear guide for this. But if there were, the marginal or additional benefit afforded by the last unit of the service rendered would best be "priced" at the marginal or added cost of providing this unit; and such would be the price, or rather, the tax per unit for all.

Similar difficulties attend taxation according to cost of service. On occasion, a kind of welding of benefit and cost is attempted, in "user taxes," to recoup from beneficiaries at least some of the cost of a service the latter otherwise would have chosen to buy. Both principles have but limited application, and sound appraisal of tax incidence is critical to hitting the proper taxpayer target in their implementation. Government enterprise that yields a marketable economic good ordinarily is viewed first as to pricing to cover average cost. Economists generally argue against this, and hold that the optimum output can best be had at marginal cost pricing. However, the social purpose to be served by government rather than private enterprise may lead to calculated departure from this manner of financing, requiring either tax support or that the project yield net revenue.

The benefit and cost principles quickly run counter to "ability to pay," a fascinating concept that has drawn much attention in the literature of public finance. Unfortunately, practical as well as theoretical difficulties of interpretation and application have blunted this approach to equity in devising tax formulae. One interpretation holds that taxes should be proportionate to, say, wealth and income. Another and more prevalent view of ability holds that the larger income receivers should pay relatively higher taxes than should smaller income receivers; this on the assumption that a strictly uniform proportional tax entails a lesser degree of "sacrifice" by the former as compared with the latter. This conviction has provided a powerful conceptual guide toward adopting progressive rates in income and

death taxes, yet it has never offered a precise yardstick for formulation of specific schedules of tax rate graduation. Its growing number of challengers argue that, because of variations in personal tastes, in family and other responsibilities, in objectives, et cetera, individuals differ too widely in their appraisal of the significance of money income to permit reliance on the concept. Even a lump-sum tax, say of $1,000, might mean a greater personal sacrifice to one who receives income of $20,000 than to another who receives income of $10,000. Critics have developed analyses of progression to show that it is likely to miss the mark to rely solely on an ascending bracket rate structure.[2] Other factors are influential, too, in determining the degree of progression in an income tax, such as differential tax treatment by types of income, allowance of exemptions and deductions from income, use of annual or an average income, failure to include income in kind, et cetera. Granted that all this makes progression a hazardous tool to reach a target "ability to pay," the view strongly persists that the principle of diminishing marginal utility of money income has at least meaningful general applicability.

From a different tack, progressive taxation is supported by a view that the market place and related institutions cause incomes to be too unequal, an inequality that should be lessened by such taxation. One rationale for this holds that the economy otherwise is hampered by over-saving and under-consumption. As a rule such considerations arise concerning federal taxation, relative to implementation of fiscal policy. Because of incidence, the many state, local, and federal proportional taxes are generally assumed to lead to regressive burden. If the latter comes to be considered too unsatisfactory, not adequately compensated for by the existing or altered progressive federal income tax, progression increasingly could become a theme in state tax legislation.

A felt need to be realistic and to avoid the dilemma concerning sacrifice has led to occasional emphasis upon such concepts as "expediency," "adequacy," and "neutrality" in choosing and structuring taxes. A characteristic interpretation of expediency appears partly grounded in equity, however, where there is selection and implementation of those revenue sources which seem to work best from the dual standpoint of revenue-getting and political acceptance.

In a sense, a variant of this and of the benefit principle, is the proposal that no new expansion of governmental services be undertaken unless and until each expenditure proposal is acceptably paired with a revenue measure to provide the requisite financing. Attractive as this approach may at first appear, it could often prove legislatively impractical. It could, over time, produce an awkward array of twin measures that might defeat rather than promote the general sense of equity.

[2] Amotz Morag, "Reflections on Progressive Taxation," *National Tax Journal*, Vol. XI, No. 3, September 1958, pp. 219-229.

That a tax system should provide adequate revenue may appear to be a commonplace practical observation, not subject to argument. Yet here may be the genesis of a significant principle. For example, (Harvey E.) Brazer has recently suggested that "an adequate tax system is one which provides sufficient revenue to meet the costs of providing public services for a growing population and an expanding economy without frequent changes in tax rates or tax bases."[3]

Many emphasize a test of "neutrality" in choosing and structuring taxes. This approach would seek to leave the taxpayers and the economy as nearly as possible in the same relative position after as before the tax. This stems from a firm belief among economists that free market decisions automatically tend to achieve the most defensible degree of equity and efficiency, and that conscious effort in government to obtain tax neutrality will risk least departure therefrom. This, too, is difficult to implement. A too hasty interpretation would take the existing situation as a given, and seek to achieve neutrality only as to the subsequent tax legislation. This might instead, aggravate unneutrality. There should always be the challenge that the existing tax system itself is unneutral, and that new tax legislation may need to resolve this, at least in part.

In this connection there is impressive theoretical support for income as against commodity taxation, in that the former interferes the least with existing patterns of purchase preference in terms of level of economic welfare. Income taxes reduce purchasing power, of course, yet commodity taxes to raise the same amount of revenue are anticipated to shift forward so importantly on this narrower base as to create a different pattern of higher effective prices and to enforce greater absolute and relative reductions in consumption. In other words, neutrality of tax treatment appears easier to achieve with income than with commodity taxation.

Whatever may be the dominant philosophy at any one time in these matters, and despite the recognized absence of absolute guides to equity, it does seem that arbitrariness of tax action may be much reduced as tax shifting and incidence are taken into account.

The "Diffusion" Theory of Tax Incidence

According to one minority conviction of long standing, tracing of tax shifting and incidence might well be abandoned except, possibly, as to short-run adjustments. This is the "diffusion" theory that contemplates taxes being shifted again and again until, given enough time, each person in the economic society inevitably comes to bear some determinate portion. The older the tax, the more general becomes its ultimate incidence, carried by economic transactions until the amount obtained from each person reaches that proportion of the total tax which (1) according to an early

[3] Glenn W. Fisher, "An Economist's Appraisal of the Illinois Tax System," University of Illinois *Law Forum,* Taxation in Illinois: Vol. 1961, Winter Number, pp. 543-585. Reference is to Harvey E. Brazer, *Taxation in Michigan: An Appraisal,* 1 (1961), Michigan Pamphlet No. 30, Institute of Public Administration, The University of Michigan.

view, his net income bears to total net income, or (2) as to another view, his consumptions bears to total consumption.[4]

Whereas most writers dismiss this type of theory as inadequate, they do so with reluctance, observing that there is some truth in it. As evidence, note the long history of toleration of old taxes, coupled with strenuous opposition to new taxes. If the weight of taxes inevitably spreads in the manner and degree indicated, there is logic in opposing new taxes. But it is this inevitability that is criticized. Aside from the short-run ordeal of adjustment, until a new tax becomes "old," the many skeptics would also challenge any sense of complacency concerning the old taxes. Moreover, the process of adjustment develops economic changes of differing intensities as taxes initially non-consumption in character might move toward the alleged distribution according to consumption, or consumption taxes according to income. Observed exceptions appear too great for such easy dismissal.

"Concentration" Theories of Tax Incidence

There is also some theorizing that all taxes tend to concentrate, or converge, upon a particular object or type of income, without any necessary diffusion to all members of a society. The eighteenth century Physiocrats in France, for example, believed taxes to come to rest upon net income of land. They advocated a single tax of this character. Henry George and others have made similar proposals, but not necessarily on the assumption of inevitable concentration of existing taxes on economic rent of land. The English economist, J. A. Hobson, in 1920 theorized that taxes eventually bear upon surplus income in a society, on surplus received above the necessary costs of production. Any or all of the factors of production might receive surplus income, which he advocated could be taxed at progressive rates.

Here, too, there is some validity in the theory. As Professor Buehler points out, diffusion and concentration theories exaggerate certain principles of tax shifting.[5] Incidence and effects are likely to be felt in a broader context than the concentration theory implies, hence the latter is usually deemed to be too narrow to serve well as explanation and guide in tax formulation.

Economic Power and Tax Shifting—A Narrow Concept

Another over-simplified view considers tax shifting to be highly manipulative by those who are wealthy or somehow receive large incomes; that they are enabled thereby to move the weight of taxes from themselves to those of lesser wealth and income. Economic analysis has shown the process of pricing and tax shifting to be much more sophisticated than this. Even should the affluent have access to political power, the alleged likelihood remains in doubt; moreover, the rise of popular government would seem to

[4] The diffusion theory was given wide attention as it was stated by the French writer Nicholas Francois Canard in 1801. In the United States David Wells gave it affirmation in 1911, with emphasis on consumption. For a brief discussion see Harold M. Groves, *Financing Government*, 4th edition (New York: Henry Holt & Company, 1954), pp. 104-5.

[5] Alfred G. Buehler, *Public Finance*, 3rd edition (New York: McGraw-Hill Book Company, Inc., 1948), pp. 285-7.

work in the opposite direction. The favored analysis looks to aspects of costs of production and how they may differ by industries, firms, and economic goods, the degree of competition, elasticities of demand for goods and services, income elasticities of demand, incentives and disincentives for investment, work and leisure, et cetera. These operate within the economy in cause and effect ways, differing in the short run and over time, often with little relationship to sheer size of a person's wealth and income.

Some General Estimates of Tax Incidence and Burden

In the last quarter century there has been some endeavor to estimate by income classes the overall burden of federal, state and local taxes, and also distribution of benefits of governmental expenditures. These have necessitated rather arbitrary assumptions as to how and where particular types of taxes are shifted, and of degree of receipt of governmental services. Despite their tentative character, illustrative computations are presented in brief at this point, prior to a discussion of principles of incidence. One such analysis that has received wide attention was made as of 1954 and presented for consideration by the Joint Committee on the Economic Report. Materials from it are shown in Table 1.

Such data tend to support the widely-accepted view that state and local taxes are regressive relative to size of taxpayer income and that, because of the great revenue significance of the progressive federal individual income

TABLE 1

Estimated Effective Rates of Taxes and Proportions of Tax Yield, Federal, State and Local, 1954, as Percentage Of Income, by Spending Unit Income Groups

Income Class	Percent of Income: State and Local*	Percent of Income: Federal	Percent of Income: Total	Percent of Tax Yield: State and Local	Percent of Tax Yield: Federal	Percent of Tax Yield: Total
$ to $ 2,000	11.2	15.7	26.9	6.9	3.7	4.6
2,000 to 3,000	10.4	17.9	28.3	8.5	5.6	6.4
3,000 to 4,000	9.8	19.1	28.9	13.0	9.7	10.6
4,000 to 5,000	9.8	20.0	29.8	13.9	10.9	11.8
5,000 to 7,500	9.1	22.2	31.3	26.3	24.4	25.0
7,500 to 10,000	8.8	24.2	33.0	10.1	10.7	10.5
Over to 10,000	7.7	33.2	40.9	21.3	35.0	31.2
Total	9.1	23.8	32.9	100	100	100

SOURCE: R. A. Musgrave, "The Incidence of the Tax Structure and Its Effects on Consumption," in *Federal Tax Policy for Economic Growth and Stability*, Papers Submitted by Panelists Appearing before the Subcommittee on Tax Policy of the Joint Committee on the Economic Report, 84th Congress, 1st Session, Washington, D.C., Government Printing Office, 1955, p. 98.
"Percent of Income" data include social insurance contributions.

*Includes an allocation of personal and corporate income and profits taxes. Illinois does not have such taxes. They account for about 0.7 of the total of percentage points in the State and Local Percent of Income column. For each of the first four classes, through incomes to $5,000, such portion is 0.3; for the remaining sequence of income classes the respective portions are 0.6, 0.7, and 1.4.

tax, all combine to show a progressive pattern in the entire tax system. However, when the measurements are compared for state and local taxes in the $3,000 to $10,000 income range, regressivity appears slight. Those who have worked most closely with these data observe that, with somewhat different though defensible assumptions concerning shifting and incidence, the indicated regressively might largely disappear. One such analysis, utilizing "disposable receipts" as the income for sales tax comparisons, concludes that even for this tax the relationships may fluctuate close to and probably on both sides of proportionality. If so, it as argued that sweeping assumptions imputing high regressivity to proportional-rate taxes may lead to quite mistaken legislation.[6]

Attempts to estimate benefits from government expenditure, and their distribution, reveal that we have moved to a quite regressive pattern, wherein the smaller income units receive relatively the greater benefit. Available analyses, for the years 1938-39 and 1946-47, are summarized in Table 2. Although not recent, they do have the advantage of showing benefits before the social security programs had been fully implemented, and then for a postwar year when the permanence of these programs had become certain. To enable further comparison, the estimated tax burden distributions for these years and for 1954 are included in Table 2. Burden and benefit measurements are the product of value judgment applied to many variables, therefore they should be viewed as rough approximations. It should be observed that the last two columns of Table 2 relate to the proportion of total benefit in each group to aggregate benefit.

The Illinois tax system is probably more regressive relative to personal incomes than shown in the foregoing estimates for all state and local governments nation wide. Except for progressive-rate death taxes that apply mostly in the upper income classes, Illinois relies on proportional-rate taxes based heavily on tangible goods. However, as indicated in the footnote of Table 1, use of progressive income taxes in other states does not greatly affect the size of the burden percentages for all state and local governments combined.

One aspect of a showing of state and local tax burden (and benefit of government expenditures) nation wide is that this tends to rule out the knotty state "balance of payments" problem. For a single state such analysis is confronted with the question of how much of a state's taxes are borne outside the state, and how much of other states' taxes are ultimately borne within that state. Whereas excellent measurements are available of trade across the nation's borders, no comparable data are available for each state. A few special state studies that have dealt with this problem as to taxes have tended to restrict the inquiry to how much of the particular state's

---

[6] David G. Davies, "An Empirical Test of Sales-Tax Regressivity," *Journal of Political Economy*, Vol. LXVII, February 1959, pp. 72-78. "Disposable receipts" are defined to equal net money income plus certain other money receipts, plus assets sold and liabilities added, less the sum of assets acquired and liabilities disposed of.

taxes come to bear on nonresidents. As an extreme example, a Minnesota inquiry concluded that Minnesotans pay only about 2 percent of their iron ore occupation tax. It was also concluded that nearly all of the tax on life insurance premiums and on gross earnings of railroads is shifted out of Minnesota.[7] A recent Michigan study concludes that over 27 percent of their present taxes are shifted outside the state.[8] This estimate is built up

TABLE 2

Estimates of Tax Burden and of Benefits from Government Expenditures, Federal, State and Local Combined, for Selected Years, by Size of Consumer Unit Income*

Income Class (in $)	TAX BURDEN as percent of Income of Class			BENEFIT from Government As Percent of Income of Class		BENEFIT to Income Group as Percent of Aggregate Benefit	
	1954	1946/47	1938/39	1946/47	1938/39	1946/47	1938/39
Under 1,000		19.6	18.0	80.5	52.8	10.5	33.6
1,000-1,999	26.9	15.1	17.5	32.5	23.6	15.9	30.3
2,000-2,999	28.3	17.3	17.4	24.6	18.0	19.0	12.3
3,000-3,999	28.9	17.7	17.7	21.0	18.4	16.8	5.6
4,000-4,999	29.8	22.9	18.2	18.5	20.8	10.0	3.2
5,000-7,499	31.3	24.2	18.7	14.6	25.1	10.7	3.8
7,500 & over . . .		36.3	32.7	12.9	17.4	17.1	11.2
7,500-9,999	33.0						
10,000 & over . . .	40.9						
Total	32.9	24.2	20.2	20.9	25.9	100	100

SOURCE: Data for 1954 are from Table 1. Other data are from John Adler, "The Fiscal System, the Distribution of Income, and Public Welfare," in K. E. Poole, *Fiscal Policies and the American Economy*, New York, Prentice-Hall, 1951, pp. 359-421. For the 1938/39 estimates, Adler drew from Helen Tarasov, "Who Does Pay the Taxes?" Supplement IV, *Social Research*, 1942.

*Among many variables the showing is influenced by the pre-war to post-war move from high unemployment to high employment, to heavy payments to veterans, inflation and growth of real income, upward movement of income units through income brackets, et cetera. Estimation methods are roughly similar, but cannot be expected to permit close comparisons.

(by somewhat less than half) of shifting conceded to occur through deductions from income in computing federal taxes. The latter is not a conclusive allocation, as such allowances are taken in all states; certainly the federal taxes could be smaller if such deductions were not allowed. Such adjustment is pertinent to tracing the burden of all taxes; else it is a good question which tax is being reduced—state or federal.

Shifting and Incidence of Particular Taxes

Consideration of tax shifting and incidence appears to be about as old as economic and fiscal reasoning, of which it is a part. Most of it is theoreti-

[7] O. H. Brownlee, "Estimated Distribution of Minnesota Taxes and Public Expenditure Benefits," The University of Minnesota Press, No. 21, Minneapolis, 1960, pp. 10, 13.

[8] Richard A. Musgrave and Darwin W. Daicoff, "Who Pays the Michigan Taxes?" *Michigan Tax Study — Staff Papers*, Lansing, 1958, pp. 131-183, 135.

cal, a consequence of difficulty in isolating, in a statistical way tax from a myriad other influences on price. Much of the accepted theory of tax shifting has been developed through "partial equilibrium" analysis, wherein the economy is assumed to remain in equilibrium except for changes brought about by a tax. Thereafter, one by one, other significant variables can be considered, to bring the analysis closer to a believed actual status and operation of the economy. At the other extreme, not only tax shifting and incidence but also effects of related expenditures of government, plus other variables, are considered together. This second approach offers a paradox by appearing to be more realistic than partial equilibrium analysis, yet it presents such difficulties of measurement that, to date, it continues to be least amenable to empirical inquiry.

It seems useful first to set forth a number of propositions concerning our economy that have significance for taxation. It is basically capitalistic, yet with enough government intervention to cause numerous observers to term it a "mixed" economy. The following propositions are suggestive rather than meticulous and exhaustive.

1. Business enterprise is primarily profit motivated.
2. Business seeks to recoup all costs, including a minimum projected return for "enterprising."
3. Business tends to view taxes as costs.
4. Factor of production suppliers (labor and its unions, providers of investable funds, owners of land, etc.) tend to view both direct and indirect taxes as reducing their income.
5. Provision of most economic goods has extended beyond the capacity of one firm to supply each at the lowest possible cost; in most sectors there is more than one firm, often many firms. Also in many sectors the addition of more firms or other expansion in production does not serve to lower cost or price. Thus, entire industries take on "constant" or "increasing" cost conditions. Many economists suspect the latter to be the most prevalent. Technological advances are likely to alter cost levels more than to change cost tendencies; thus partial equilibrium analysis ordinarily proceeds on the assumption of a "given stage of the arts."
6. Demand for most goods and services, that is, "economic goods," involve buyers' willingness to take more units at lower than at higher prices. For some goods, of inelastic demand, price changes bring relatively little change in the number of units taken. These demand intensity patterns differ widely for different goods.
7. As personal incomes change, the foregoing demand intensities also change, but in different degrees. For example, most public utility services are believed to involve "income inelasticity of demand"—when buyers' incomes rise they do purchase more of such services, generally, but with a lesser relative increase than the rise in income.

8. Despite the dominance of a few firms in numerous industries, there is still much competition: among firms, industries, regions, substitute goods, even all goods. Yet full or "perfect" competition between many suppliers and many demanders of a good has become very limited.
9. On the other hand, there is very little perfect monopoly, where the monopolist has full rein to set output so that the resultant price will yield the largest net profit conceivably possible.
10. Government intervenes in various ways to affect economic decisions:
    a. Prohibits
    b. Regulates
    c. Subsidizes
    d. Competes
    e. Influences public opinion
11. Both provision and the stock of public (government) goods will continue to grow in quantity and complexity—faster with economic growth than in its absence.
12. Man's dream and search for abundance and leisure will continue, with much success. The faster growth of services in recent years has little more than restored its relative proportion of 1929, yet it is anticipated that this growth will continue. The growing demand for "leisure goods" appears increasingly to show a preference for services.

There are a number of prevalent key views about taxes that bear on their shifting and incidence, not necessarily dependent on any particular tax.

1. A tax can not be shifted unless there is a price to carry it elsewhere.
2. Tax shifting occurs whether or not there is conscious effort to shift.
3. However, self-interest suggests that taxpayers will seek to shift taxes to others.
4. Where economic decisions are influenced by a tax, this establishes a situation wherein the tax may shift or produce unique effects.
5. The character of a tax law will have a bearing on tax shifting, yet it would be a rare law that could compel or prohibit shifting. Compulsion to add a sales tax to the customer's bill in a retail sale does not mean that the customer necessarily bears the tax. If price maintenance is not compulsorily maintained, a demand weakening may cause firms to mark down goods to effect sales. Thus the firm may absorb part or all of the tax, or perhaps shift some of it backward.
6. It is possible for a tax to be shifted both directions in part, and in part be absorbed.
7. The degree to which there is unemployment of factors of production, such as land, labor, capital, enterpriser, or the many unique

combinations of these, has significance for shifting of taxes. If there is less than high employment of such factors, taxes may be shifted backward to the weaker bargainers. In times of full employment, taxes may be shifted forward.

8. Tax shifting and effects need not take place immediately. A tax change bearing on long-term capital investments may have no appreciable effect thereon for months, until decision makers conclude that the change is permanent or becomes significant in comparison with other factors involved.
9. Because of the usual slopes of the curves representing demand and supply, a forward-shifted tax is not likely to raise price by the amount of the tax per unit. Quantity exchanged will tend to be reduced, or at least repressed in a dynamic market.
10. A tax uniformly applied over a wide jurisdiction is more likely to be shifted than if it is unique to a locality. In the long run even the latter may be shifted, at least in part, through readjustment in investment, etc. Here the degree of shifting will depend on the cost, inconvenience, and the like, of transacting business elsewhere to avoid the tax.
11. Taxes tend to be characterized as proportional, progressive, degressive, etc., depending on the nature of the tax rate structure. Yet these differences may be sharply altered by the patterns of the rates, exemptions, deductions, credits, income averaging or other differences in computation of tax base, so that influence is exerted on shifting.
12. State and local tax systems vary among themselves; yet with continuing press for revenue there is a tendency for these to move in similar ways, with lags. Tax shifting arising through tax avoidance thus tends to be impermanent.
13. In an industry of a few dominant firms (oligopoly), taxes may alter costs yet not affect the administered prices, at least for a time. It is argued that, to avoid damaging revenue loss, no such firm will risk raising prices until it appears certain that the others will follow suit.

A consensus holds that there are unique aspects of particular types of taxes that merit special identification and discussion. These are grouped here as to taxes on income, on spending (sales), on wealth, and those arising in unique relationships.

I. Income Taxes. A consensus has long held that a tax on net income, individual or business, can not be shifted. This involves an assumption that all such incomes have become as high as the recipients know how to make them. It then follows that a uniform tax on net income must be borne at the point of legal impact, as no superior income situation will be available in which to recoup any of the tax. There has been some challenge of this as

to the individual income tax, and the appearance of a new consensus that at least the corporation net income tax is subject to shifting.

A. Individual income taxes are generally believed to be non-shiftable.

1. If the tax applies widely and uniformly to pure economic surplus, such as economic rent of land as land, or income that results from a uniquely superior mental or physical human capacity and ability, the accepted theory is that none of this income tax is shiftable. A state income tax may be avoided, of course, where the income source is capable of removal to another state.
2. However, a general net income tax reduces taxpayer purchasing power, enforcing limitations on his purchases. He will cut back on acquisition of different goods in varying degrees, depending on relative intensities of his demand for them. In the whole society prices for some things may fall, or be held down in comparison with others, so that in effect the income tax may in part be shifted to factors of production of goods and services for which demand is highly elastic, and supply inelastic.
3. Sharp tax progression is frequently argued to reduce work incentive and thus create a condition for shifting. Several empirical studies of income taxes have found this situation mixed, with only minor support at best that work incentives have been so reduced.[9]
4. It is frequently argued that high progressive rates in the upper large income brackets reduce incentives to invest. To the extent that this occurs the provision of the capital factor is restricted; thus capital prices tend to rise and the prices of the cooperating factors tend to fall or to be relatively restricted.
5. Despite qualifications, the view predominates that, for the individual income tax, the initial taxpayer is also the ultimate taxpayer.

B. Corporate net income taxes may be subject to shifting.

1. A tax of wide and uniform application on unique net income of a pure rent or economic surplus character would tend to resist shifting. Where this element is disproportionately large, it might invite abandonments of the corporate form to avoid the tax.
2. The corporate form is easily available, and there always appear to be marginal and sub-marginal firms organized in this manner. This variable amount of non-profit competition would appear to reduce shiftability of the corporation net income tax.
3. However, as mentioned earlier, regulated public utility corporations are generally presumed to recoup income as well as other taxes, where the market will permit.

[9] George F. Break, "Income Tax Rates and Work Incentives: Empirical Evidence." *Tax Revision Compendium* (of Papers on Broadening the Tax Base), submitted to the Committee on Ways and Means, pp. 247-55. (Committee Print) Washington: Government Printing Office, 1959.

4. A conviction is growing that corporate managements scan investment opportunities with the corporation income tax rates definitely in mind. It is argued that there is a shifting process that excludes all projects that do not promise to cover the 52% tax *in addition to* the desired net target rate of return. To the extent that this is practiced, an arbitrary gap in investment occurs, tending to shift at least some of the tax both backward and forward.

TABLE 3

Estimated Amount of Tax Payable Under Illinois Sales Taxes, 1960, and Under A Replacement Proportional-Rate Income Tax to Yield the Same Total Revenue, by Four-Member Families, by Income Class*

	Estimated Dollars of Tax		
Adjusted Gross Income Class of at Least:	Paid Under Illinois Sales Tax	Payable Under 2¼% Adjusted Gross Income Tax (No pers. exempt. Or Deduct.)	Income Tax is Less (—) more (+)
$ 1,000	$ 48	$ 23	$− 25
1,500	58	34	− 24
2,500	78	56	− 22
3,500	101	79	− 22
4,500	121	101	− 20
5,500	142	124	− 18
6,500	160	146	− 14
7,500	178	169	− 9
8,500	192	191	− 1
9,500	206	214	+ 8
11,000	227	248	+ 21
13,000	249	293	+ 44
15,000	265	338	+ 73
17,000	276	383	+107
19,000	280	428	+148

SOURCE: "Income Tax vs. Sales Tax," Research Report Pursuant to Proposal 555 sponsored by Representative Peter J. Miller. Illinois Legislative Council, Bulletin 4-370. Springfield, May 1962. From Table 6.

*The report notes that "of the almost 2.6 million families in Illinois, about 80 percent had family incomes of less than $10,000 in1959, according to the Bureau of Census." About 15% were under $3,000, and about 31% were under $5,000. (The Census Bureau believes that its informants probably understated size of annual income somewhat because of reliance on memory).

Nevertheless, there is opposing considered opinion, to the effect that "capital probably bears close to the full burden of the tax," and that there is no support for "frequently heard allegations that large fractions of the corporation income tax burden fall on laborers or consumers or both."[10]

[10] Arnold C. Harberger, "The Incidence of the Corporation Income Tax," *Journal of Political Economy*, Vol. LXX, June 1962, pp. 215-240.

5. Historically, empirical studies tended to assign the incidence entirely to shareholders. Some recent studies have experimented with assumed fractions suggesting that one-half or less of the tax may be shifted elsewhere, to consumers and to some of the factors of production.

The Illinois Legislative Council recently constructed tentative income tax formulae of various yields, including one of 2¼% proportional rate that would yield as much revenue as the Illinois sales tax structure provided in 1960. This tax would be on adjusted gross personal income (as defined in the Federal law), with no personal exemptions or deductions. If substituted for the sales taxes it would have given tax relief (to four-member families) over a substantial range of lower level incomes. The estimates are presented in Table 3.

II. Sales Taxes. This category includes general and special retail sales taxes, excise, and gross receipts taxes. Although based on spending, Illinois does not have the comprehensive coverage to approximate that of a so-called spending tax law. The usual assumption is that these taxes are completely shifted, forward to ultimate consumers. There is increasing challenge of this sweeping assumption.

1. The more general and the wider the coverage of a sales tax, the more likely it is to be shifted.
2. Even if all-inclusive, a sales tax will not shift forward evenly because:
   a. The tax rate is usually a percent, making for higher absolute effective price increases on the higher value than on the lower value goods.
   b. Demand intensities for different goods and services are not only unequal at any one time but are subject to change over periods of time.

   An analysis of consumer spending in 1961 concluded that significant changes had occurred in consumer spending habits, 1956 to 1961:[11]

	Amount Spent Out of Each Dollar 1961	1956
Spending increased, for:		
Housing	26.9c	26.5c
Medical care	6.8	5.7
Recreation	6.1	5.6
Interest on debt, legal fees, etc.	6.6	5.4
Personal care (haircuts, etc.)	1.7	1.4
Church, other donations	1.5	1.3
Education (college, private schools)	1.5	1.1

[11] *U. S. News & World Report,* December 18, 1961, page 65.

No change:		
Gasoline, tires, repairs	6.4	6.4
Foreign travel, payments abroad	.9	.9
Spending decreasing, for:		
Food	21.2	23.1
Clothing, jewelry	9.9	11.0
Tobacco, liquor	5.2	5.4
Auto, new or used	4.2	5.0
Public transportation	1.1	1.2

As another trend significant for sales taxation, a recent study shows farm family spending in the United States, as a percent of urban family spending, increased from 30% in 1941 to 48% in 1955.[12] This was total for current consumption. For food and beverages the percent rose from 30 to 47, housing from 30 to 47, and clothing and personal care from 41 to 66. Much of this is sales taxable.

c. As more of family funds are budgeted to goods and services for which their demand is relatively inelastic, less is allocated to purchase of other items.

d. Such reallocation of funds in the market leads to changes in volume and cost of production of various goods.

e. Tax restrained purchases tend to cause
   1. Reductions in markups, application of markdowns. (Tax absorption)
   2. Dealer pressures on suppliers to reduce prices. (Backward shifting)
   3. Obstacles to wage and other factor income increases. (Backward shifting and absorption.)
   4. In the short run there is undoubtedly some absorption of the tax by taxed firms, and some backward shifting to suppliers and factors. In the long run there will be more shifting forward. But there will be a less optimum allocation of resources, as the tax is not a true production cost yet must be treated as a cost in gauging amounts of goods to produce.

f. The trend of personal incomes is upward, which probably works to increase the degree of forward shifting of sales taxes. Again the effect can be uneven because of differing elasticities and inelasticities for goods in relation to income increases.

g. The fact of business failures, and of difficulties of tax collection from these and even marginal firms, suggests that there is more downward pressure on markups than is commonly supposed.

[12] "Farm Family Spending in the United States," Agriculture Information Bulletin No. 192, Agricultural Research Service, U. S. Department of Agriculture, p. 2. Washington: Superintendent of Documents, 1958.

h. Institutional features, such as union bargaining strength, may create resistance to tax shifting. This resistance may be weaker as to forward shifting, as compared with backward shifting.

3. Selective sales taxes are likely to be selected for inelasticity of demand, as for cigarettes and probably motor fuels. A common assumption is that the consumer bears the full tax. In the case of motor fuels purchased by business firms there is much forward shifting, subject to a number of counter influences already noted.

III. Property Taxes

1. Accepted theory still holds that a property tax on land tends to fall on the owner of the land at the time tax increases are made. Basic to this view is the theory that such incidence is not just the annual increase for a year, but the present value of all future such portions of tax. This is an employment of the "capitalization" theory, the application of which has been modified as indicated in the example below.

   Suppose a tract of land is anticipated to yield a net income of $600 per year forever. If investors want and get 5% on such investments, the capitalized value of the land will be $12,000. Suppose a new property tax of 1% is adopted, again forever. The $600 then becomes a combined return of 6% of a capital value, assuming also that there is full-value assessment. Because of the tax the capital value drops to $10,000. The annual tax of 1% will be $100, and the 5% return, $500. As a modification it has long been suggested that such an increase in tax is likely to be accompanied by increases in other taxes, so that investors may have to be content with a lower rate of return on alternative investments. Suppose this rate goes to 4%. Then, with the tax, $600 per year will equal a combined rate of 5% on a capital value. The value of the tract will stay at $12,000. Assuming full assessment the 1% tax will take $120 of the income and leave $480 as a net 4% return.

2. A property tax newly imposed on improvements is believed to be borne by the owner at the time the tax is imposed, in the same manner as indicated in 1 above. Improvements, however, are reproducible, and it is deemed unlikely that they will be replaced until higher rentals or other income of such property may rise to justify it.
   a. The foregoing theory is most difficult to detect in practice. Rising personal incomes, relative scarcities of housing, rising real estate prices, obsolescence because of technological advance, very much cloud the picture.
   b. Moreover, government intervention has undoubtedly influenced farm land values.

c. It also seems unrealistic to hold that very early owners really bore the real estate tax or much of it when the annual property tax bills continue year after year over decades. Here is a case where many factors bear on property prices, and separation of tax influence does not lend itself to statistical proof.

d. Studies of tax burden are likely to place tax incidence on residential real estate with the tenant or owner-occupier. In the latter case such tracing is made difficult because of the Federal income tax. For the latter does not call for inclusion of imputed owner income from his residence, and at the same time it permits deduction from his other income the property taxes thereon and any mortgage interest relating to it.

e. Also, forward shifting is usually ascribed to taxes on commercial and industrial property.

3. Personal property taxes are generally considered to have their incidence on the owners unless such property is used in business. In that case such taxes are believed to be shifted forward under normal circumstances.

4. Death taxes are commonly considered to be borne by the recipients of property passing at death. Because of exemptions and progressive rates, their incidence and burden tends to gravitate to the higher income groups, mainly for classes above $7,500 annual income.

IV. Other Taxes. Pari-mutuel, license, privilege, and other types of special taxes are discussed in other papers of this series. Inasmuch as pari-mutuel taxes reduce winnings, it is argued that they are shifted to the winners. Individual passenger motor vehicle licenses are deemed high enough to be classified as taxes, yet in Illinois they apparently fall short of affecting the sale of such motor vehicles. Accordingly their incidence is believed to be on the owners. Generally, where special taxes are directed at business firms, it is likely that they are shifted forward for the most part.

Concluding Comment

Perhaps no one would argue against exercise of great care and judgment in the selection and structuring of taxes. Because of the likelihood of most taxes to shift after legal impact, incidence becomes a matter of high concern in the choice and utilization of revenue sources. Yet a comprehension of the processes and possibilities of such shifting, while indispensable, is not enough. There must be the final exercise of judgment as to where equity may lie in the tapping of revenue sources. Difficulties of marshalling empirical evidence to bear on these matters promise long to be a hampering factor.

Decision-making of this character is complicated not only by the intricacies of achieved state and local public finance structures but also by the

revenue getting, transferring, and spending of the federal government. As if this were not enough, we are reminded that there are foreign economies and governments in the trading world, and that availabilities of international goods at competitive prices may restrain domestic tax shifting because of their influence on the price vehicle.[13]

Whereas indeterminacies may long hamper empirical study of shifting and incidence of taxes, the literature of public finance does provide relevant principles of help in attainment of greater justice in taxation.

---

[13] Robert H. Parks, "Theory of Tax Incidence" (International Aspects), *National Tax Journal,* Vol. XIV, June 1961, pp. 190-197.

CHAPTER X

CONSTITUTIONAL PROBLEMS

By J. Nelson Young*

Introduction

This study of constitutional problems affecting the revenue is in two parts. The first part deals with the questions which arise under the present provisions of Article IX of the Illinois Constitution of 1870. The second part treats with the proposals for revision of the revenue article. The former looks to the immediate problems which may be encountered in implementing our revenue needs, and the latter to the changes which should be considered for the future.

PART I — PROPOSED REVENUE MEASURES

A. Motor Fuel Tax

1. **Separate Classification of Diesel Fuel.** In the report upon highway-user charges, it is noted that the present uniform rate per gallon imposed under the Motor Fuel Tax discriminates against the operators of gasoline-powered vehicles and in favor of the operators of diesel-powered vehicles.[1] To equalize the burden of the Motor Fuel Tax as between the respective users, it is recommended that consideration be given to the imposition of a tax at a higher rate per gallon upon diesel fuel than upon gasoline. As indicated in the report, this recommendation is based upon studies sponsored by the United States Bureau of Public Roads which establish that diesel-powered vehicles of comparable size and operated under similar conditions consume substantially less fuel per mile than is the case with respect to gasoline-powered vehicles. On the basis of the data assembled, it is estimated that a differential of approximately 40% is required to equalize the burden as between the users of the two types of fuel. With gasoline taxed at the present rate of five cents per gallon, the suggested differential would result in a rate of seven cents per gallon upon diesel fuel. In this connection, a question has been raised as to whether the recommendation could be implemented without violating the uniformity requirement of Article IX, Section 1 which provides that an occupation, franchise, or privilege tax shall be "uniform as to the class upon which it operates."

A review of the decisions bearing on this question indicate that a separate classification of diesel fuel and the imposition of a higher tax thereon would be valid. Support for this conclusion is found in the decision in *People v. Deep Rock Oil Corp.*[2] which sustained the Motor Fuel Tax enacted in

---

*The author is Professor of Law at the University of Illinois. The author gratefully acknowledges the research assistance of Hugh P. Morrison, Jr., a graduate of the College of Law, and Roger E. Lageschulte, a third-year student in the law school.

[1] Harbeson, *Highway-User Charges*, p. 569 *infra*.

[2] 343 Ill. 388, 175 N.E. 572 (1931).

1929. One of the principal objections presented was that there was an unreasonable discrimination against users of gasoline in view of the exclusion of kerosene oil and electricity as motor fuels under the provisions of the act. The court, in sustaining the act, accorded to the legislature a broad discretion in classifying objects for taxation:

> "It may be that the legislature considered that the use of highways by motor vehicles using other than gasoline to furnish propelling power was so small, when compared with other uses of such excluded materials for power, as to render a privilege tax on the use thereof on the highways of little or no benefit above the cost of collection and reimbursement, or that as to electricity no method exists for measuring the use of the highways by vehicles so propelled. Whether such are the facts, and whether, if so, they were considered by the legislature, we may not definitely know. *The matter of classification is within legislative discretion, subject to review for abuse thereof,* and we cannot say that the classification here bears no reasonable relation to the purposes of the act."[3]

On the basis of this decision, if it is permissible in the discretion of the legislature to exempt certain fuels entirely, it would follow a fortiori that some fuels could be taxed at a different rate than other fuels if there were a rational basis for such classification. It is significant that in the *Deep Rock* decision the court broadly deferred to the judgment of the legislature with respect to the propriety of the classification adopted. From the opinion, it is apparent that the court approached the question with the orthodox view that there is an initial presumption that the legislative classification is reasonable and that it is to be overturned only in the face of exceptionally persuasive or compelling reasons. The only reservation expressed in the opinion was that the classification was "subject to [judicial] review for abuse thereof." There was no suggestion, however, as to what, if any, definitive standard was being applied by the court as a criterion in determining whether the particular classification constituted an "abuse" of legislative discretion.

One must turn to a more recent case to find a helpful formula for determining the resonableness of the proposed separate classification of diesel fuel. In *Bode* v. *Barrett*,[4] the Motor Vehicle Law as amended was challenged on the ground that the increases in license fees imposed with respect to various classes of vehicles resulted in unreasonable and discriminatory classification contrary to sections 1 and 2 of Article IX of the constitution. In overruling this contention, the court observed that "as to classification and subclassification within the act, it must clearly appear that the judgment of the legislature is erroneous or that the discretion vested in the legislature has been arbitrarily abused." On this point, the court concluded with the following comment:

> "[T]he Motor Vehicle Law imposes a tax on trucks graduated according

[3] 343 Ill. at 399, 175 N.E. at 578. (Emphasis added).
[4] 412 Ill. 204, 106 N.E. 2d 521, *aff'd*, 344 U.S. 583, 73 Sup. Ct. 468 (1952).

> to weight bracket which, when combined with the motor fuel taxes paid, will approximately equalize the taxes paid per ton-mile of all motor vehicle operators, passenger and truck. The taxes imposed by the amended act have a reasonable basis, are not discriminatory, and do not produce a revenue in excess of fair and reasonable compensation for the privilege of using the State roads."[5]

On the basis of the statistics assembled in the study of highway-user charges, an increased rate upon diesel fuel would serve to more nearly equalize the tax burden as between users of gasoline-powered vehicles and diesel-powered vehicles. Thus, it is clear that a reasonable basis for the separate classification of diesel fuel could be established.

Other Illinois decisions can be cited to support the separate classification of diesel fuel for purposes of the motor fuel tax. Probably the most significant of these decisions is *Peoples Gas Co.* v. *City of Chicago*.[6] In that case the court considered the question as to whether the provisions of the Cities and Villages Act authorizing municipalities to impose gross receipts taxes upon certain public utilities at rates not to exceed five percent created an unconstitutional classification. The question arose with respect to the enactment of ordinances by the City of Chicago which imposed gross receipts taxes at an effective rate of five percent upon the gas company and an effective rate of only one percent upon the electric utility company. The ordinances adopted pursuant to the statute imposed gross receipts taxes at the rate of five percent upon both utilities. In the case of the electric utility company, however, a credit was allowed against the gross receipts tax for a franchise fee of four percent which was paid to the city for the use of its streets. This produced an effective rate of one percent. Since the gas company was not subject to a city franchise fee, it was taxed at the full five percent rate. Inasmuch as the combined franchise fees and gross receipts taxes in each case aggregated five percent, the question as to lack of uniformity might have been avoided by applying a net effect test. However, the court noted that the municipalities were authorized by the statute to impose gross receipts taxes upon any or all of the four types of utility companies (gas, electricity, water, transmission of messages) at rates which could be varied as to each type of utility but which could not in any case exceed five percent. Thus the court squarely faced the question as to the propriety of a differential in rates as between the several utilities.

It was contended in *Peoples Gas Co.* that since gas and electric services are competitive, particularly for use as fuel, it was unreasonable to separately classify them for purposes of taxation. The court observed that "great latitude is given legislative bodies to classify trades, callings, occupations or businesses, the only requirement being that the classification rest on a reasonable basis," and directed attention to the fact that Article IX, Section 1, specifically authorizes separate classification of competing occupations—e.g.,

---

[5] 412 Ill. at 228, 106 N.E. 2d at 533.
[6] 9 Ill. 2d 348, 137 N.E. 2d 330 (1956).

peddlers, hawkers, merchants, and commission merchants; showmen and jugglers; toll bridges and ferries.[7] The court acknowledged that competition is a factor to be considered in determining the propriety of the classification, but noted that in the particular circumstances gas and electricity were no longer competitive with respect to such a significant use as illumination. However, the court did not choose to validate the separate classification of gas and electricity on the basis of the demonstrated differences in competitive positions:

> "[A]lthough there are no Illinois authorities directly in point [with respect to the separate classification of gas and electricity], there are cases where this court has upheld legislative classifications that differentiated between objects having similar characteristics or attributes. (*Johnson* v. *Halpin*, 413 Ill. 257, cigarettes, as distinguished from other tobacco products; *People* v. *Deep Rock Oil Corp.*, 343 Ill. 388, gasoline, as distinguished from other kinds of motor fuel; *Routt* v. *Barrett*, 396 Ill. 322, horse racing, as distinguished from harness racing; *Reif* v. *Barrett*, 355 Ill. 104, sale of tangible personal property generally, as distinguished from sales under conditional sales contracts or sales on time or credit. See also *Heisler* v. *Thomas Colliery Co.*, 260 U.S. 245, bituminous coal, as distinguished from anthracite coal, and *Southwestern Oil Co.* v. *Texas*, 217 U.S. 114, wholesale dealers in coal, oil, naphtha, benzine, or any other mineral oils refined from petroleum, as distinguished from other wholesalers.) Indeed classifications have been approved where a general occupation has itself been subdivided in some reasonable manner. *McGrath* v. *City of Chicago*, 309 Ill. 515, tax on furniture movers graduated according to size and number of vehicles operated; *Metropolis Theater Co.* v. *City of Chicago*, 246 Ill. 20, graduated license fees for theaters based on price of admission."[8]

The only direct authority brought to the attention of the court with respect to the propriety of separately classifying gas and electricity for tax purposes were two cases involving an occupation tax imposed by the City of Lincoln, Nebraska, which discriminated against the local gas company.[9] In both cases it had been held that the ordinance which classified the gas company separately from the electric company for purposes of imposing an occupation tax violated the constitutional requirement of uniformity. These decisions dating back to 1909 and 1916, had emphasized the competitive position of the two businesses in furnishing light, heat and power to the public. The court found these cases unpersuasive in view of the subsequent substantial changes in the competitive positions of the two industries and emphasized a dissenting opinion in the Nebraska case in which the dissenting judge had stressed the essential differences in the nature of the two types of business.[10]

---

[7] 9 Ill. 2d at 353-54, 137 N.E. 2d at 333.

[8] 9 Ill. 2d at 355-56, 137 N.E. 2d at 334.

[9] Lincoln Gas & Electric Light Co. v. City of Lincoln, 182 Fed. 926 (1909); City of Lincoln v. Lincoln Gas & Electric Light Co., 100 Neb. 182, 158 N.W. 962 (1916).

[10] "The real question is whether there is any such difference in the occupation of manufacturing and selling gas and that of producing and selling electricity as to afford room for classification. It seems to me there is no room for doubt here. An electrician carries on an entirely different occupation from that of a gasmaker, and makes a different product, though it may be used for some similar purposes." City of Lincoln v. Lincoln Gas & Electric Light Co., 100 Neb. at 185; 158 N.W. at 963.

It is of special significance to note that in the *Peoples Gas Co.* decision the court commented upon the necessity of interpreting the constitutional provisions in the light of changing conditions:

> "The foregoing [changes in the use of gas], in our opinion, indicates one of the hazards of erecting a constitutional bar to the instant classification and supports that view which leaves it with legislative bodies to keep pace with changes and make needed adjustments through ordinary political processes."[11]

With this statement, the court lent added weight to its position that the legislature should be accorded considerable respect in matters of classification.

As indicated in the report on highway-user charges, several states impose higher gallonage taxes on diesel fuel than on gasoline. To this extent, there is a recognized pattern of separate classification. Furthermore, a Michigan decision provides added authority to sustain the classification. In *Lake Shore Coach Lines* v. *Alger*,[12] the statute in question created three classifications: gasoline was taxed at 3 cents per gallon; diesel fuel used in vehicles operated under a municipal franchise was taxed at 4 cents per gallon; and diesel fuel used in vehicles operated on the public roads and highways of the state was taxed at 5 cents per gallon. The objection in this case was directed at the rate differential between diesel fuel used in vehicles operated under municipal franchises and diesel fuel used in vehicles operated upon the public highways generally. It was contended that the separate classification violated the constitutional requirement that specific taxes "shall be uniform upon the classes upon which they operate."[13] The court observed that the lesser tax on diesel fuel used in vehicles operated under a municipal franchise could be justified on the ground that the state highway fund contributed very little to the repair and upkeep of city streets and sustained the tax as one based upon a reasonable classification:

> "Sufficient reasons may fairly be considered as actually existing to furnish a valid reason for the legislature in passing [the] Act . . . to differentiate between users of diesel motor fuel in vehicles operating under municipal franchises and other users of diesel motor fuel on public highways. Such differentiation we consider not unjust but based on sound and fair judgment."[14]

It is of interest to note that reference was made in *Lake Shore Coach Lines* to testimony that a gallon of diesel motor fuel would propel a vehicle with fifty percent more power than a gallon of gasoline. This was followed with the observation that there was no complaint that the tax of five cents a gallon for diesel fuel used in diesel-powered vehicles operated on the state highways generally was unreasonable as compared to the tax of three cents a gallon upon gasoline.

Conclusion: The separate classification of diesel fuel under the Motor

---

[11] 9 Ill. 2d at 355, 137 N.E. 2d at 333.
[12] 327 Mich. 146, 41 N.W. 2d 503 (1950).
[13] Mich. Const. art 10, § 4 (1908).
[14] 327 Mich. at 154, 41 N.W. 2d at 506-07.

Fuel Tax would not violate the uniformity requirements of Article IX, Section 1.

2. Tax Upon Nonhighway Use. In the study of highway-user charges in Illinois, it is pointed out that the total consumption of gasoline for nonhighway purposes in this state in 1960 was second only to New York and that the consumption of gasoline for agricultural use exceeded that of any other state by a substantial margin.[15] It was concluded that the relatively high rate of consumption for agricultural purposes may warrant more effective audit and verification of refund claims. This would, of course, increase administrative costs. In public hearings held by the Commission, it was suggested that consideration be given to eliminating refunds of the motor fuel tax with respect to nonhighway consumption.

If it were decided as a matter of policy to tax gasoline and other fuels consumed in operating airplanes, farm equipment, boats and other vehicles off the highways, there would be a question as to how this decision should be implemented. The present motor fuel tax is "imposed on the privilege of operating motor vehicles upon the public highways of this State" and specific provision is made for refund of the tax with respect to nonhighway use.[16] In a recent case, *Pascal* v. *Lyons*,[17] it was contended that the regulations requiring collection of the motor fuel tax on aviation gasoline with provision for subsequent refund were unreasonable in view of the purpose of the act. It was argued that aviation gasoline should be exempt from the tax in the first instance inasmuch as the motor fuel tax is imposed upon the privilege of using the highways. The court sustained the regulation on the ground that the statute required collection of the tax on all sales of gasoline in the first instance and observed that the consumer is adequately protected by the refund provisions. The court recognized, however, that the tax is clearly imposed upon the privilege of operating motor vehicles upon the public highways. Repeal of the refund provisions of the act would not extend the scope of the tax to fuel consumed in operating vehicles off the highways since the title and specific provisions would limit the application of the tax. By its terms, the tax could not be validly applied to nonhighway use.

There are alternative methods of imposing a tax upon the nonhighway use of motor fuel. The present statute might be amended to impose a tax upon "the privilege of operating motor vehicles in this State." In that case, the character of the motor fuel tax as a tax upon the privilege of using the public highways would be wholly altered. There might be some question as to whether a taxable privilege, based upon the consumption of motor fuel, could be cast in these broad terms. Doubt on this point would seem to have been resolved by the decision in *Johnson* v. *Halpin*[18] where the concept of

---

[15] Harbeson, *Highway-User Charges*, p. 573 *infra*.
[16] Ill. Rev. Stat. ch. 120, § 418 and § 429 (1961).
[17] 15 Ill. 2d 41, 153 N.E. 2d 817 (1958).
[18] 413 Ill. 257, 108 N.E. 2d 429 (1952), *cert. denied*, 345 U.S. 923, 73 Sup. Ct. 781 (1953). See the discussion of the *Johnson* case *infra* at page 366.

taxable privilege was defined in exceptionally broad terms. If the tax were recast in these terms, however, there would be a serious question as to whether the tax could be imposed with respect to motor fuel sold for consumption in vehicles operated in interstate commerce. The state cannot impose a tax upon the privilege of engaging in interstate commerce, but it can impose a tax as a compensatory measure for the privilege of using the public highways of the state.[19] It would be inadvisable, therefore, to alter the fundamental basis of the long-standing motor fuel tax which has been sustained in its present form as a valid tax upon the privilege of using the public highways. The preferable solution would be the adoption of a special fuel tax or taxes to be made applicable with respect to fuel consumed in off-highway uses.

In reliance upon *Johnson* v. *Halpin,* there would appear to be no serious constitutional question with respect to the imposition of a tax upon the privilege of operating motor vehicles within the State of Illinois other than upon the public highways at a fixed rate per gallon of motor fuel used. Similarly, a tax could be imposed upon the privilege of operating stationary engines. Contrary to the regular motor fuel tax, a tax upon nonhighway uses of motor fuel would be in the nature of a general revenue measure rather than a compensatory exaction. Legislation implementing a policy decision to extend the taxation of motor fuels in this manner would require a careful definition of the vehicles and engines which were to be brought within the scope of the act.

Taxation of fuels sold for use in airplanes would present a special problem since a large quantity of such fuel is used in interstate flights. A state cannot, of course, impose a tax upon airlines for the privilege of engaging in interstate commerce. A state can, however, impose a tax upon the sale or use of aviation fuel even though such sale or use is for consumption in interstate flights. The United States Supreme Court, in an early case, sustained a state tax upon the "sale or use" of aviation fuel withdrawn from local storage tanks and placed in planes for consumption in interstate flights on the ground that there was a local taxable incident:

> "[T]he tax is not levied upon the consumption of gasoline in furnishing motive power for respondent's interstate planes. The tax is applied to the stored gasoline as it is withdrawn from the storage tanks at the airport and placed in the planes. No tax is collected for gasoline consumed in respondent's planes either on coming into the state or on going out. It is at the time of withdrawal alone that 'use' is measured for the purposes of the tax. The stored gasoline is deemed to be 'used' within the state and therefore subject to the tax, when it is withdrawn from the tanks . . . .
>
> "A state may validly tax the 'use' to which gasoline is put in withdrawing it from storage within the state, and placing it in the tanks of

[19] Interstate Transit, Inc. v. Lindsey, 283 U.S. 183, 51 Sup. Ct. 380 (1931).

the planes, notwithstanding that its ultimate function is to generate motive power for carrying on interstate commerce."[20]

It should be observed that motor fuel sales in Illinois are not only subject to the motor fuel tax, but also to the retailers' occupation and use taxes.[21] To the extent that aviation fuel is subjected to the retailers' occupation and use taxes, there may be some question as a matter of policy with respect to the imposition of an additional tax. But policy considerations in the taxation of aviation fuel may not differ from those relating to the taxation of motor fuel inasmuch as the compensatory factor with respect to the construction and maintenance of facilities at public expense may be as relevant to air transportation as it is to highway transportation.

It is understood, however, that aviation fuel used by interstate air carriers is frequently purchased out of state and stored in Illinois for use in interstate flights. Under these circumstances, the retailers' occupation tax would not apply and, except for the gallonage withdrawn for use or consumption while flying within the state, the fuel *may* escape the use tax under the terms of the exemption provisions relating to the temporary storage of property acquired outside the state.[22] Thus, it appears that a considerable volume of aviation fuel may escape taxation in Illinois altogether. It may be desirable, therefore, to consider an amendment of the use tax or the imposition of a special aviation fuel tax to apply to all aviation fuel sold or withdrawn from storage in Illinois.[23]

Conclusion: It would be inadvisable to alter the present motor fuel tax to reach nonhighway uses of motor fuel. A separate tax or taxes upon nonhighway uses could be imposed under properly drafted legislation. Amendment of the use tax provisions may be desirable to remove any doubt as to the application of the tax to aviation fuel purchased out of state and stored temporarily in Illinois for use by interstate airlines.

---

[20] Edelman v. Boeing Air Transport, 289 U.S. 249, 251-52, 53 Sup. Ct. 591, 592 (1933).

[21] Since the motor fuel tax is imposed upon the consumer, it is excluded from the selling price in determining the retailers' occupation tax. ILL. DEPT. OF REV., RETAILERS' OCCUPATION TAX, RULES AND REG., Rule No. 52 (1962).

[22] The use tax is not applicable with respect to "the temporary storage, in this State, of tangible personal property which is acquired outside this State and which, subsequent to being brought into this State and stored here temporarily, is used solely outside this State or physically attached to or incorporated into other tangible personal property that is used solely outside this State." Ill. Rev. Stat., ch. 120. § 439.3 (d) (1961). It might be argued that the tax should apply only to fuel withdrawn from storage and consumed while in flight within the state. The Department of Revenue takes the view that mere withdrawal from storage constitutes a taxable use. DEPT. REV. BULL., June 3, 1963.

[23] If in addition to the general retailers' occupation and use taxes a special use tax were imposed upon aviation fuel, there would be a question as to the violation of the rule of uniformity and double taxation of the same privilege. As to these objections, it may be answered that the expenditure of state and local funds in the construction and maintenance of aviation facilities justifies a separate classification. It should be noted that a question as to double taxation of the same privilege with respect to the operation of automobiles in the State has been raised in connection with the imposition of both the motor fuel tax and the licensing requirements of the motor vehicle law. To this objection, the court in *Bode* v. *Barrett*, in reliance upon *Deep Rock Oil Corp.*, replied as follows:

> "There is no constitutional inhibition against more than one privilege or excise tax where the total does not exceed reasonable taxation for the privilege enjoyed. It is incumbent on the plaintiffs to show that the aggregate charge bears no reasonable relation to the privilege granted." 412 Ill. 204, at 218-19, 106 N.E. 2d 521, at 529.

There is some difference, however, in the case of the motor vehicle license provisions and the motor fuel tax in that each statute employs a different measure for the tax or fee imposed. There is an additional difference in that the motor vehicle license fees and motor fuel taxes are substantially earmarked for highway purposes. If a special aviation fuel tax were specifically earmarked for purposes of aviation it is likely that the validity of the tax as a compensatory measure would be enhanced.

B. Income Tax

1. Tax on Gross or Net Income as a Privilege Tax. The issue which pervades the current discussion of fundamental changes in the revenue structure of the state is whether an income tax could be imposed as a valid general privilege tax. The constitutional issue is fundamentally the same whether a tax were imposed upon the privilege of receiving net income or upon the privilege of receiving gross income. In either case, the ultimate question is one as to whether the Supreme Court of Illinois is prepared to set aside the decision in *Bachrach* v. *Nelson*.[24]

In the *Bachrach* case the court was confronted with the question as to the validity of a graduated "tax upon persons and fiduciaries based upon income."[25] The statute coupled graduated rates with allowances of personal and dependency exemptions. Capital gains and losses were excluded from the determination of income. A credit was allowed on a proportional basis for property taxes paid on income-producing property and up to $100 for property taxes paid upon the taxpayer's residence. The statute was declared unconstitutional on the ground that it imposed a property tax in violation of the uniformity requirements of Article IX of the Illinois Constitution. In holding a tax upon income to be a tax upon property, the court made no distinction between gross income or net income. Consequently, unless set aside, the decision operates as a restriction upon either a net income tax or a gross income tax.

Rationale of the *Bachrach* Decision

The problem presented in *Bachrach* was one of construing Sections 1 and 2 of Article IX which are fully set forth for convenient reference:

> "§ 1. The General Assembly shall provide such revenue as may be needful by levying a tax, by valuation, so that every person and corporation shall pay a tax in proportion to the value of his, her or its property—such value to be ascertained by some person or persons, to be elected or appointed in such manner as the General Assembly shall direct and not otherwise; but the General Assembly shall have power to tax peddlers, auctioneers, brokers, hawkers, merchants, commission merchants, showmen, jugglers, innkeepers, grocery-keepers, liquor-dealers, toll bridges, ferries, insurance, telegraph and express interests or business, vendors of patents, and persons or corporations owning or using franchises and privileges, in such manner as it shall, from time to time, direct by general law, uniform as to the class upon which it operates.
>
> "§ 2. The specification of the objects and subjects of taxation shall not deprive the General Assembly of the power to require other subjects or objects to be taxed, in such manner as may be consistent with the principles of taxation fixed in this Constitution."

To assess the probabilities of the *Bachrach* decision being overruled, it is helpful to assemble the specific points relied upon by the court and to appraise these propositions in a perspective afforded by the lapse of time and subsequent developments. Proceeding chronologically, the following

---

[24] 349 Ill. 579, 182 N.E. 909 (1932).
[25] Ill. Laws 1st Spec. Sess. 1931-32, at 91.

propositions can be gleaned from the *Bachrach* opinion to construct the foundation upon which the decision was premised. Each proposition is a paraphase or summary of the several extracts from the opinion.

PROPOSITION 1: *Article IX, Section 1, of the Constitution of 1870 which was derived from Section 2, Article IX, of the Constitution of 1848, makes a general property tax mandatory as the principal basis for equitably apportioning the tax burden. Occupation, franchise and privilege taxes are authorized merely as supplementary taxes.*

> "By Section 2 of the Constitution of 1848 it is apparent that the general property tax was made mandatory and that general property taxation by valuation was made the exclusive method of apportioning the tax burden 'so that every person and corporation shall pay a tax in proportion to the value of his or her property.' "[26]
>
> "It is also clear that the court, in construing Section 1 of Article 9 of our Constitution, recognized the fact that the Constitution limits taxation to a general property tax to be based upon value, and that such provision in the Constitution was for the purpose of insuring equality in the levying and collection of taxes to support the government, whether levied for state, county, or municipal purposes."[27]
>
> "[T]his court has consistently interpreted the plain and unambiguous language of the Constitution, by which all needful revenue shall be raised 'by levying a tax, by valuation, so that every person and corporation shall pay a tax in proportion to the value of his, her or its property', as intended to cast the burdens of taxation equally upon all property of every description in the state. . . . And we have just as consistently refused to extend those constitutional provisions beyond the clear impact of the language employed where the tax imposed was not a tax upon property or did not fall within the exception contained in Section 9 of Article 9 respecting special assessments . . . *or where it was not of the supplementary character of special taxes or license fees on occupations, franchises, and privileges specifically authorized by Section 2 of Article 9 of the Constitution.*"[28]

PROPOSITION 2: *Article IX, Section 1, of the Constitution limits the revenue power of the state to ad valorem property taxes, and occupation, franchise, or privilege taxes.*

> "The omission of a provision for a poll tax or capitation tax in the Constitution of 1870, and the expressed specification in section 1 of article 9 of the 1870 Constitution, which was the old section 2 of the 1848 Constitution, providing that the General Assembly should raise all needful revenue by levying property taxes on an ad valorem basis, with the exception for a tax on occupations, franchises, and privileges, make it clear that Section 1 of Article 9 of the Constitution of 1870 is a limitation on the power of the legislature to raise revenue, confining it to (1) property taxes on a valuation basis; (2) occupation taxes; and (3) franchise or privilege taxes."[29]

PROPOSITION 3: *An income tax cannot be sustained under Section 2 of*

[26] 349 Ill. at 586, 182 N.E. at 912.
[27] 349 Ill. at 589, 182 N.E. at 913.
[28] 349 Ill. at 591, 182 N.E. at 913-14. (Emphasis added).
[29] 349 Ill. at 588-89, 182 N.E. at 913.

Article IX on the ground that it is neither a property tax nor an occupation, franchise or privilege tax. Section 2 does not authorize the imposition of any other kind or type of tax than those authorized by Section 1. Section 2 merely permits the legislature to add to the list of occupations, franchises and privileges designated in Section 1.

"Section 6 of Article 9 of the Constitution of 1848 is identical with Section 2 of Article 9 of the Constitution of 1870. The obvious purpose of this section was to permit the General Assembly to add new occupations, franchises, and privileges to the list specifically designated for taxation by the preceding Section 2 in the Constitution of 1848 and by Section 1 in the Constitution of 1870."[30]

"The appellants have cited numerous decisions of this court to sustain their argument that the authority conferred by Section 2 of Article 9 of the present constitution is sufficient to sustain the present Income Tax Law. This section, it will be remembered, provides that 'the specification of the objects and subjects of taxation shall not deprive the General Assembly of the power to require other subjects or objects to be taxed,' etc. We have examined these citations relied upon . . ., but do not find any of them relevant, since they all pertain to taxes or license fees either upon occupations, franchises, or privileges and *it is not claimed that an income tax falls within any of these classifications.*"[31]

PROPOSITION 4: *Income is property and a graduated tax thereon violates the uniformity requirements of Section 1 of Article IX.*

"We come now to a consideration of whether 'income' is property. The overwhelming weight of judicial authority holds that it is. The cases . . . define what is personal property and in substance hold that money or any other thing of value acquired as gain or profit from capital or labor is property, and that, in the aggregate, these acquisitions constitute income, and, in accordance with the axiom that the whole includes all of its parts, income includes property and nothing but property, and therefore is itself property."[32]

"As heretofore shown, the word 'property' as used in our Constitution includes income and income is 'property.' Therefore it necessarily follows that under the Constitution of the state all taxes must be levied on property by valuation, so that every person and corporation shall pay a tax in proportion to the valuation of his or its property. The 1932 Income Tax Law is an attempt to levy a tax upon property (income) by means of a graduated scale that increases in rate as applied to increases from property and personal earnings. It therefore violates the constitutional provision that all taxes must be levied on property according to valuation. It is not uniform in its operation and does not equalize the burden of taxation, as required by the Constitution. It is a proposed tax on property by graduation rather than by valuation."[33]

Appraisal of the *Bachrach* Decision

Current appraisal of the *Bachrach* decision requires consideration of the extent to which the court continues to adhere to the propositions ad-

---

[30] 349 Ill. at 587, 182 N.E. at 912.
[31] 349 Ill. at 590-91, 182 N.E. at 913. (Emphasis added).
[32] 349 Ill. at 591-92, 182 N.E. at 914.
[33] 349 Ill. at 595-96, 182 N.E. at 915.

vanced in the *Bachrach* opinion. Each of these propositions is reviewed in the order presented above.

Proposition 1: The first proposition laid down by the court was that Section 1 of Article IX made it mandatory that the General Assembly impose a property tax as the principal source of revenue and that all other taxes could only be supplementary thereto. In a recent perceptive study of the constitutionality of a state income tax, Professor Cohn has noted that this proposition was unequivocally discarded by the same court fourteen months later in *Reif* v. *Barrett*,[34] a decision sustaining the retailers' occupation tax:

> "In answering the contention that the retailer's occupation tax might produce sufficient taxes so that owners of real and personal property might not have to pay any taxes on such property, the court said:
>
> > 'If in the suppositious case advanced by the appellants (which case we find some difficulty in assuming) there was raised from the occupation tax a sufficient fund to relieve those tax-payers who did not come under the class embraced in the provisions of the Retailer's Occupation Tax act from paying any real estate or personal property tax, there would be no violation of the constitutional provisions as to uniformity and equality in taxation, nor would there be any commutation of taxes violative of the constitution. Under the constitution the legislature is limited in its power to levy three classes of taxes, as above stated. The constitution does not require all three of such classes of taxes to be levied—it merely restricts the levy of taxes to these three classes.' [Reif v. Barrett, 355 Ill. 104, 137, 188 N.E. 889, 902-03.]
>
> It is, of course, an ironic addendum that the 'suppositious case' which the court found 'some difficulty in assuming,' actually occurred almost before the ink was dry on its opinion and that in fact no state property taxes have been levied and collected for any purpose since 1932. Thus the pervading principle of a mandatory property tax necessary to equality of distribution of the tax burden, so boldly and confidently asserted in *Bachrach*, was completely negated by the same court within a span of 14 months, with the result that no person or corporation, since 1932, has paid a tax in proportion to the value of his, her, or its property."[35]

Proposition 2: The second proposition relied upon was that Article IX, Section 1 limits the taxing power of the state to ad valorem property taxes and occupation, franchise or privilege taxes. This conclusion was based upon a detailed historical review by the court of the development of the provisions of the revenue article of the Constitution of 1870 and was correlative to its first proposition, namely, that a property tax was mandatory. The accuracy of the conclusion reached by the court has been ably challenged by Professor Lucas on the basis of logic, history and precedent.[36] More recently, Professor Cohn has suggested that the court in effect overruled its conclusion in *Bachrach* as to the historical meaning of Sections 1 and 2 of Article IX

---

[34] 355 Ill. 104, 188 N.E. 889 (1934).

[35] Cohn, *Constitutional Limitations on Income Taxation in Illinois*, 1961 U. Ill. Law Forum 586, 597-98.

[36] Lucas, *Nonproperty Taxes Under the Illinois Constitution*, 25 U. Chi. L. Rev. 63 (1957).

by discarding in *Reif* v. *Barrett* the proposition that a general property tax is mandatory.[37]

Although there is a sound basis for challenging the second proposition of the *Bachrach* decision as to the limitation upon the kind or type of taxes which can be imposed, the court has consistently recognized or accepted these limitations in two of the most important revenue cases to come before it in recent years. In *Johnson* v. *Halpin,*[38] sustaining the cigarette use tax, reference was made to the "scholarly historical review of the revenue article" in the *Bachrach* case, and the court expressly accepted the prior construction of the revenue article "as restricting the taxing power of the legislature to (1) property taxes on an *ad valorem* basis, (2) occupational taxes, and (3) franchise or privilege taxes."[39] Again, in *Turner* v. *Wright,*[40] the court accepted the restrictive interpretation of the revenue article as laid down in *Bachrach,* but proceeded to recognize the complementary use tax as a privilege tax.[41] No effort was made in either of these cases to quarrel with the *Bachrach* conclusion.

The fact that the court has continued to accept, without challenge, the limitations imposed by the *Bachrach* decision upon the kind or type of taxes which might be enacted does not, however, foredoom the current acceptance of an income tax. The significance of the recent use tax decisions does not lie in their recognition of the limitations as to the kinds of taxes permitted under *Bachrach,* but rather in the court's adoption of a broad concept of taxable privilege. In effect, the court at once adhered to the limitations of *Bachrach* and freed itself of the restrictions imposed by that decision.

In *Johnson* v. *Halpin,* the court ruled upon the constitutionality of "an Act in relation to a tax upon the privilege of using cigarettes in this State." In challenging the tax, it was contended that the term "privilege" employed in the revenue article as a subject of taxation implies some benefit affirmatively conferred by the state. The Attorney General, on the other hand, argued that since the state in the exercise of the police power could abolish the use of cigarettes, it was conferring a benefit by refraining from exercising its power. Although the court could have based its decision solely upon the broad power which the legislature might exert with respect to the use of cigarettes, it refused to accept either of the suggested restrictions upon the scope of taxable privilege:

> "We find no merit either in plaintiff's benefit theory of privilege, which has no support either in the constitution or in the decisions; or in defendant's theory of benefit conferred through the State's failure to prohibit."

[37] Cohn, *Constitutional Limitations on Income Taxation in Illinois,* 1961 U. Ill. Law Forum, 586, 598.

[38] 413 Ill. 257, 108 N.E. 2d 429 (1952), *cert. denied,* 345 U.S. 923, 73 Sup. Ct. 81 (1953).

[39] 413 Ill. at 265, 108 N.E. 2d at 434.

[40] 11 Ill. 2d 161, 142 N.E. 2d 84 (1957).

[41] It should be noted, however, that the court qualified its recognition of *Bachrach* by stating that the limitations expressed therein proceeded from "broad dictum." 11 Ill. 2d at 164, 142 N.E. 2d at 86.

> "In ascertaining the scope of the concept of privilege under the revenue article, we propose to analyze the nature of the taxable privileges sustained by the Illinois courts, and the definitions of the term 'privilege' as used in connection with the taxing power which appear in the case law of Illinois and other jurisdictions."[42]

After an extensive review of a number of cases, the court concluded with the following all-embracing definition of taxable privilege:

> "On the basis of the foregoing analysis, it is apparent that the concept of 'privilege' with reference to the taxing power has not been limited in Illinois, or in other States, to conduct previously authorized by the legislature, or which the legislature could entirely abolish, or to benefits conferred by the State. For the right to use the streets and the highways, and the right to make intervivos gifts which are effective at death, all of which have been sustained as taxable privileges in Illinois, were regarded as common rights open to all persons prior to legislative action thereon. Therefore, a taxable privilege may involve lawful rights and conduct enjoyed without previous legal authority, but over which the legislature has some power of control or classification. A tax upon such rights would be valid provided the classification were reasonable, and the statute provided for uniformity among the constituents of the class. *Harder's Storage Co.* v. *City of Chicago,* 235 Ill. 58.
>
> "This interpretation of taxable privilege under the Illinois constitution is consistent with the construction of the legislative power to tax occupations, whereby lawful occupations, engaged in as a matter of inherent right have been deemed to be subject to a tax provided the classification of such occupations is reasonable. *Rief* v. *Barrett*, 355 Ill. 104."[43]

In the subsequent decision in *Turner* v. *Wright* sustaining the complementary use tax, the court quoted the above excerpt from the *Johnson* case in answer to the argument that a use tax was not within the scope of a "privilege" tax. The fact that the court in the *Turner* case proceeded to premise its decision upon the complementary or protective nature of the use tax in relation to the retailers' occupation tax does not detract from its commitment to the broad concept of taxable privilege. On the contrary, the endorsement of this concept in a situation unnecessary to the decision emphasizes the court's adherence to this position. It is apparent that with the adoption of a broad-gauged approach to the concept of taxable privilege the court, while adhering to the limitations on the revenue power as expressed in *Bachrach,* has taken a long step toward the effective removal of the restrictions of that decision.

---

[42] 413 Ill. at 266-67, 108 N.E. 2d at 435.

[43] 413 Ill. at 270, 108 N.E. 2d at 436. It will be observed that the court, after stating that "a taxable privilege may involve lawful rights and conduct enjoyed without previous legal authority," added the following qualification: "*but over which the legislature has some power of control or classification.*" (Emphasis added.) There may be a question as to whether this subsequent qualification was intended to restrict the scope of taxable privilege. Cohn, *op. cit. supra* note 35, at 604-06. However, in view of the context in which the question as to the nature of a taxable privilege was presented and considered by the court, it is submitted that this qualifying clause was merely added as a caveat to indicate that the legislature is not free to tax the exercise of *all* lawful rights or conduct. The state cannot, for example, control or classify for purposes of taxation the exercise of the right of free speech or the exercise of the right to worship, both of which are protected by the first amendment of the United States Constitution. *E.g.*, Grosjean v. American Press Co., 297 U.S. 233, 56 Sup. Ct. 444 (1936); Follett v. Town of McCormick, 321 U.S. 573, 64 Sup. Ct. 717 (1944).

Proposition 3: The third proposition in the *Bachrach* decision was set forth in response to the Attorney General's contention that an income tax is neither a property tax, nor an occupation, franchise or privilege tax but a tax upon another "subject or object" within the scope of Section 2 of Article IX.[44] In taking this position, the Attorney General relied principally upon the decision in *Harder's Storage Co.* v. *Chicago*[45] where the court had sustained a wheel tax ordinance as a "privilege" tax or in the alternative as a valid tax within the designation of "other subjects or objects" specified in Section 2 of Article IX. The court summarily answered the Attorney General's contention by stating that Section 2 did not expand upon the type or nature of taxes permitted by Section 1 and waived aside the cases cited by the state on the ground that all of them dealt only with occupation, franchise or privilege taxes.

At this juncture, the third proposition set forth in the *Bachrach* case assumes special significance. As previously indicated, the court observed that *"it is not claimed that an income tax falls within any of these classifications"*[46] i.e., within the classification of occupation, franchise, or privilege taxes authorized by Section 1 of Article IX. Consequently, the court in *Bachrach* did not specifically consider the question as to the validity of an income tax as a "privilege" tax. This is particularly important in the light of the recently expanded concept of taxable "privilege" as set forth in the use tax decisions.

Proposition 4: The final proposition advanced in the *Bachrach* case—that an income tax is a property tax—is the critical issue in the current discussion. Unless there is a reasonably persuasive and plausible basis upon which the court might overrule this conclusion, there is no point in seriously considering the enactment of an income tax measure. With respect to this proposition, an exceptionally strong case can be made for reversal of the position taken in the *Bachrach* decision. The several arguments are enumerated in the following paragraphs.

The Case for Overruling the *Bachrach* Decision

(1) The conclusion in *Bachrach* that an income tax is a property tax was directly contrary to an earlier decision of the court.

Nine years prior to the *Bachrach* decision, it had been held that an income tax was not a property tax. This earlier decision was one of the principal cases relied upon by the Attorney General, but the court in its opinion ignored it entirely. In *Young* v. *Illinois Athletic Club*,[47] the court had been presented with a question as to whether a tenant was obligated by the terms of his lease to defray the federal income taxes assessed upon the landlord's receipt of rent. The lease provided that the lessee should pay "as additional rent for the real estate hereby demised . . . all taxes . . . of every nature and kind whatsoever, which may be (a) levied, imposed or assessed

[44] Brief for Appellants, pp. 13-14.
[45] 235 Ill. 58, 85 N.E. 245 (1908).
[46] 349 Ill. at 591, 182 N.E. at 913.
[47] 310 Ill. 75, 141 N.E. 369 (1923).

upon the real estate hereby demised . . .; or (b) levied, imposed or assessed upon any interest of the lessor in or under this lease; or (c) which the lessor shall be required to pay by reason of or on account of his interest in the real estate hereby demised. . . ." The court observed that under these provisions of the lease the lessee would be liable for all taxes imposed upon the property and acknowledged that "the sole question . . . is whether or not an income tax [upon rents] is a tax imposed upon an interest in real estate."

The principal case relied upon by the landlord was the decision in *Pollock v. Farmers' Loan & Trust Co.*[48] which had held the federal income tax of 1894 unconstitutional as a direct tax. In the *Pollock* case, the United States Supreme Court concluded that a tax upon the income from property was essentially the same as a tax upon the property itself. In its opinion in the *Young* case, the Illinois Supreme Court distinguished the *Pollock* case and specifically recognized the significant difference between an income tax and a property tax:

> "The issue arising in the *Pollock cases,* therefore is not whether an income tax was a tax on real estate or an interest therein, but whether such tax based on rentals was a direct tax and therefore within the prohibition of the constitution.
>
> "An income tax is not similar to other forms of taxation, since it is not imposed upon property or business but upon the proceeds arising therefrom. (Black on Income and Other Federal Taxes, Sec. 1.) An income tax is an assessment upon the net income of the person and not upon any particular property from which that income is derived."[49]

(2) The court was in error in asserting that the "overwhelming weight of authority" had held an income tax to be a property tax.

It is true that at the time the *Bachrach* case was decided there was a conflict of authority as to whether an income tax was a property tax. The weight of authority, however, clearly supported the view that an income tax was not a property tax. On this point, Professor Lucas has made the following observation:

> "[I]n stating that by the overwhelming weight of judicial authority income from property is property, the court is patently in error. Cooley, in his work on taxation, has this to say on the matter: 'There is a considerable conflict of opinion as to how income taxes should be classified. Are they a property tax or are they an excise tax or are they neither the one nor the other but instead a separate class standing by themselves? If they are to be deemed a property tax, constitutional limitations applicable to property taxes must be applied, thereby limiting the power of the legislature. If they are excise taxes, such limitations are not applicable . . . In regard to state income taxes the law is not so clear. Generally, however, it has been held that the tax is not a tax on property, or at least is not such a tax as to be included in the constitutional limitations imposed upon property taxes.' "[50]

In 1937, five years after the *Bachrach* decision had been rendered, the

[48] 157 U.S. 429, 15 Sup. Ct. 673 (1895), *modified on rehearing,* 158 U.S. 601, 15 Sup. Ct. 912 (1895).
[49] 310 Ill. at 80-81, 141 N.E. at 371.
[50] Lucas, *Nonproperty Taxes Under the Illinois Constitution,* 25 U. Chi. L. Rev. 63, at 98 (1957).

United States Supreme Court in a case involving a question under the Iowa income tax, commented upon the authorities relating to an income tax:

> "The question as to the nature of such a tax has come up repeatedly under state constitutions requiring taxes upon property to be equal and uniform, or imposing similar restrictions. Many, perhaps most, courts hold that a net income tax is to be classified as an excise. 'The tax levied on income is not a property tax, but is a percentage laid on the amount which a man receives, irrespective of whether he spends it, wastes it, or invests it.' Featherstone v. Norman, 170 Ga. 370, 382, 153 S.E. 58, 65, 70 A.L.R. 449; Purnell v. Page, 133 N.C. 125, 129, 45 S.E. 534. As early as 1870, the Supreme Court of Iowa had written an opinion which foreshadows the same thought. Dubuque v. Northwestern Life Ins. Co., 29 Iowa 9. Cf. Vilas v. Iowa State Board of Assessment and Review (Iowa) 273 N.W. 338. True, there are courts in other states that teach a different doctrine."[51]

Many decisions were collected by the court and were included in the footnotes to support its observation on this point.[52]

(3) It is generally recognized that an income tax is essentially different than a property tax.

That an income tax is different than a general property tax is so well established at this point as to hardly warrant the assertion of the proposition. One of the most incisive and succinct statements of the essential difference between the two has been made by Professor Magill:

> "The income tax is not laid upon any particular receipt by the taxpayer nor indeed upon the series of receipts during a year, *as such*. The tax is measured by the flow of receipts during a period of time; unlike the property tax it is not imposed upon the total of one's wealth on a particular day. Hence, a tax upon incomes appears to be quite a different tax from one upon property. In the parlance of corporation finance, the one utilizes an income statement, the other a balance sheet. The taxes are laid upon quite different subjects, and will yield quite different results."[53]

(4) A critical evaluation of the rule of the *Bachrach* decision in the light of fundamental principles underlying the general property tax confirms the essential difference between an income tax and a property tax.

---

[51] Hale v. Iowa State Bd. of Assessment and Review, 302 U.S. 95, at 104-05, 58 Sup. Ct. 102, at 105 (1937). (Footnotes omitted).

[52] The following cases and materials were cited by the Court in support of its conclusions. (1) Cases holding an income tax to be an excise tax: Sims v. Ahrens, 167 Ark. 557, 271 S.W. 720 (1925); Stanley v. Gates, 179 Ark. 886, 19 S.W. 2d 1000 (1929); Waring v. Savannah, 60 Ga. 93, 100 (1878); Featherstone v. Norman, 170 Ga. 370, 379, 153 S.E. 58 (1930); Diefendorf v. Gallet, 51 Idaho 619, 627, 10 P. 2d 307 (1932); Miles v. Department of Treasury, 209 Ind. 172, 199 N.E. 372 (1935); In re Opinion of the Justices, 133 Me. 525, 178 A. 820 (1935); Hattiesburg Grocery Co. v. Robertson, 126 Miss. 34, 52, 88 So. 4 (1921); Ludlow-Saylor Wire Co. v. Wollbrinck, 275 Mo. 339, 351, 205 S.W. 196 (1918); Bacon v. Ranson, 331 Mo. 985, 990 56 S.W. 2d 786 (1932); O'Connell v. State Board of Equalization, 95 Mont. 91, 112, 25 P. 2d 114 (1933); Mills v. State Board of Equalization, 97 Mont. 13, 17, 33 P. 2d 563 (1934); Maxwell, Commissioner, v. Kent-Coffey Mfg. Co., 204 N.C. 365, 371, 168 S.E. 397 (1933); Hunton v. Commonwealth, 166 Va. 229, 243, 183 S.E. 873 (1936); Appeal of Van Dyke, 217 Wis. 528, 535, 259 N.W. 700 (1935); 4 Cooley on Taxation (4th Ed.) ¶ 1743. Brown, *The Nature of the Income Tax*, 17 Minn. L. Rev. 127, 130, 139. (2) Cases holding an income tax to be a property tax: Eliasberg Bros. Mercantile Co. v. Grimes, 204 Ala. 492, 86 So. 56 (1920); Bachrach v. Nelson, 349 Ill. 579, 182 N.E. 909 (1932); In re Opinion of the Justices, 220 Mass. 613, 624, 108 N.E. 570 (1915); Id., 266 Mass. 583, 585, 165 N.E. 900 (1929); Harrison v. Commissioner of Corporations, 272 Mass. 422, 427, 172 N.E. 605 (1930); Redfield v. Fisher, 135 Or. 180, 192, 292 P. 813, 295 P. 461 (1930-1931); Kelley v. Kalodner, 320 Pa. 180, 185, 181 A. 598 (1935); Culliton v. Chase, 174 Wash. 363, 25 P. 2d 81 (1933); Jensen v. Henneford, 185 Wash. 209, 216, 53 P. 2d 607 (1936).

[53] Magill, TAXABLE INCOME 223 (Rev. Ed. 1945).

Logically, if income is "property" which can be taxed only in accordance with the principles governing our general property tax, it should be included as a separate item subject to assessment upon the tax rolls. Although there can be no quarrel with the conclusion that income is generally realized or received in the form of property, income received by a taxpayer is normally expended in the acquistion of other property or in the consumption of goods and services. To the extent that income is invested in real and personal property which is owned on tax day, there would be double taxation if the amount of income and the property representing the investment of that income were both included on the tax rolls. On the other hand, to the extent that income is expended in the consumption of goods and services, there would be no property owned by the taxpayer on tax day to be included on the tax rolls. But if income is "property" subject to taxation in accordance with the principles of Article IX, there can be no exemption or exclusion of property from taxation except as authorized by Section 3 with respect to publicly owned property and property of educational, religious and charitable organizations.

In *Bachrach,* the court distinguished neither between gross income and net income, nor between income retained by the taxpayer and income expended by the taxpayer. If both retained income and the property in which it were invested were taxed, there would be double taxation. If expended income were taxed, there would be a tax upon property which the taxpayer did not own. And if expended income were not taxed, there would appear to be an improper exemption of property from taxation. For these reasons, a tax upon income which constitutes a flow of receipts over a period of time is conceptually different than a general property tax which is based upon the property owned by the taxpayer at a particular time. To treat income as "property" for purposes of a general property tax creates a complete impasse.

(5) The *Pollock* case which was accorded considerable weight in the *Bachrach* decision, has been effectively overruled by the United States Supreme Court.

As previously indicated, the Illinois Supreme Court had been confronted in *Young* v. *Illinois Athletic Club* with the holding in *Pollock* v. *Farmers' Loan & Trust Co.* that a tax upon income from property was equivalent to a tax upon the property which produced the income. Although the court in its opinion in the *Young* decision clearly distinguished the *Pollock* case, it chose in the *Bachrach* decision to place great stress upon the holding in *Pollock*, citing and quoting from that decision in support of the conclusion that "a tax upon the income of property is in reality a tax upon the property itself."[54]

On this point, account must be taken of the subsequent decision of the United States Supreme Court in *New York ex rel Cohn* v. *Graves.*[55] One of the questions presented in that case was whether the State of New York

[54] 349 Ill. at 595, 182 N.E. at 915.
[55] 300 U.S. 308, 57 Sup. Ct. 466 (1937).

could constitutionally tax a resident upon the rental income received from New Jersey real estate. In sustaining the tax in the face of the argument that it was invalid as a tax upon the New Jersey property, the court stated:

> "Nothing which was said or decided in Pollock v. Farmers' Loan & Trust Co., . . . calls for a different conclusion. There the question for decision was whether a federal tax on income derived from rents of land is a direct tax requiring apportionment under article 1, section 2, clause 3 of the Constitution. In holding that the tax was 'direct,' the Court did not rest its decision upon the ground that the tax was a tax on the land, or that it was subject to every limitation which the Constitution imposes on property taxes. It determined only that for purposes of apportionment there were similarities in the operation of the two kinds of tax which made it appropriate to classify both as direct, and within the constitutional command."[56]

In view of this statement, it is apparent that the *Pollack* case is no longer authority for the position taken in the *Bachrach* decision as to the nature of an income tax.

(6) The doctrine of stare decisis is no bar to the court's reconsideration of its conclusion that a tax on income is a tax on property.

Although adherence to the doctrine of stare decisis is important to the stability of the law, it is never a bar to the correction of error. The Illinois Supreme Court has frequently recognized a duty to re-examine a question when reasonable doubt exists as to the correctness of prior decisions.[57]

On the question as to the nature of an income tax, there are two factors which weigh heavily in favor of reconsideration. The first is the manifest weight of authority both at the time the *Bachrach* decision was rendered and at the present date. The second is the fact that the *Bachrach* decision constituted a complete departure from the rule enunciated in the court's earlier decision in *Young* v. *Illinois Athletic Club*.

(7) The court recently has adhered to a policy of careful re-examination of its position in cases involving the revenue.

During the last several years, the court has demonstrated a marked inclination to reconsider prior doctrines with respect to questions affecting the revenue. In *Johnson* v. *Halpin*, the cigarette use tax case, the court proceeded at great length to reconsider the concept of taxable "privilege." In *Turner* v. *Wright* the court in the first instance announced a decision holding the complementary use tax unconstitutional. This decision was subsequently withdrawn and, upon rehearing, a majority of the court joined in sustaining the tax. More recently, in *G. S. Lyon & Sons Co.* v. *Dep't. of Revenue*,[58] the court overruled a decision of long-standing to hold that the sale of building materials are subject to the retailers' occupation tax. In doing this, the court overturned a rule to which it had consistently adhered since

[56] 300 U.S. at 315, 57 Sup. Ct. at 468-69.

[57] *E.g.*, Molitor v. Kaneland Com. Unit Dist. No. 302, 18 Ill. 2d 11, 163 N.E. 2d 89 (1960), *cert. denied*, 362 U.S. 968, 80 Sup. Ct. 955 (1960).

[58] 23 Ill. 2d 180, 177 N.E. 2d 316 (1961).

the decision in 1942 in *Material Service Corp.* v. *McKibbin.*[59] In adopting a contrary position, the court stated that "upon reconsideration of the question we think that in this respect the . . . [prior decisions are] not supported by sound reasons and can no longer be followed."[60]

Conclusion: On the basis of the foregoing analysis and appraisal of the decision in *Bachrach* v. *Nelson,* it appears likely that if the question were presented the Illinois Supreme Court would reconsider its position and sustain an income tax as a privilege tax.

2. Basing a State Income Tax Upon the Federal Income Tax. Assuming that an income tax could be validly imposed under the Illinois Constitution, a question arises as to whether it would be permissible to base such a tax either upon the "amount of income" or the "amount of income tax" as determined under the Internal Revenue Code of the United States. The question is one of improper delegation of legislative authority and was first raised in this particular context under a Connecticut corporation franchise tax. The Connecticut statute provided that each domestic and foreign corporation doing business in the state should pay "a tax annually . . . upon the net income for its fiscal or calendar year next preceding . . . upon which income such company is required to pay a tax to the United States." To facilitate administration, each corporation was required by the statute to file a copy of its federal income tax return with the state authorities. In contesting the validity of the statute, it was contended among other objections that there was an improper delegation of legislative authority by basing the state tax upon income as determined under the federal income tax law. This contention was abruptly brushed aside with the following observation:

> "No delegation of legislative authority is involved in adopting . . . [the federal income tax] definition of net income. It is a matter of convenience to taxpayers and economy to the state not to set up a separate standard and another administrative establishment for the measurement of taxable net income."[61]

A similar result was reached under a Pennsylvania franchise tax which imposed a tax at the rate of 10% upon net income "as returned to, and ascertained by the federal government." In sustaining the tax against the contention that there had been an improper delegation, the court stated:

> "At the outset it is to be observed that we are not considering an income tax, but an excise tax for the privilege of doing business in the Commonwealth, based upon net income as returned to and ascertained by the Federal Government. When this situation is borne in mind, the doubts as to the legality of the tax suggested by appellant disappear. Net income as ascertained is the base upon which the tax is measured, not the tax itself. How it was fixed by the Federal authorities is of no concern to the taxing officers of the Commonwealth nor to its statute. The rate

[59] 380 Ill. 226, 43 N.E. 2d 939 (1942).

[60] 23 Ill. 2d at 186, 177 N.E. 2d at 320. In this connection, it is of some significance to observe the court's reference in *Peoples Gas Co.* v. *City of Chicago* to the necessity of interpreting the revenue provisions of the constitution in the light of changing conditions. See text at page 358 *supra*.

[61] Underwood Typewriter Co. v. Chamberlain, 94 Conn. 47, 65, 108 Atl. 154, 160-161 (1919), *aff'd*, 254 U.S. 113, 41 Sup. Ct. 45 (1920).

of the income tax may vary or the method of its computation, but as a base it is unvarying."[62]

The leading case involving the question of improper delegation of legislative authority by basing a state income tax upon the federal income tax is *Featherstone* v. *Norman*,[63] sustaining the validity of the Georgia income tax. In general, the Georgia statute provided that persons residing in or doing business in Georgia should file a tax return reporting the same information as contained in the federal income tax return. With certain unimportant exceptions, the statute provided that "net income taxable by the state of Georgia shall be the same as that taxable by the United States, and the tax payable thereon to the state of Georgia shall be one third of that payable to the United States." Thus, the tax under the state statute was premised wholly upon the amount of the income tax liability determined under the Internal Revenue Code.

After determining that the income tax was an excise tax and not a property tax, the court dealt at length with the contention that to base the state tax on the amount of the federal tax constituted an improper delegation of legislative power contrary to the state constitutional provision that "the legislative power of the state shall be vested in the General Assembly."[64] The court found this objection to be without merit:

> "[T]his act does not delegate to Congress and its instrumentalities the power to fix and determine rates of taxation, the exemptions therefrom, the subjects thereof, and to promulgate rules and regulations touching administrative features of the act. All these things are done by the state itself. The Georgia Legislature fixes the rate of tax which a taxpayer shall pay. This is one-third of the amount of the tax which he pays or would pay to the federal government upon the bases above stated. The Legislature makes certain exemptions from the payment of this tax. It names and specifies these exemptions. The Legislature makes or provides for the making of the rules and regulations relating to the administration of this act. This act merely adopts the federal method of calculating net income under the federal statute as the state's method of accomplishing that result. The mere adoption of the method fixed by the federal law is not vesting in Congress the power to create the state's method. It adopts existing exemptions and an existing method in determining in part the net taxable income of the taxpayer. *Adoption of existing exemptions and an existing method is not a delegation to Congress of the legislative power of the state.*"[65]

At another point, the court emphasized the fact that the state statute did not attempt to incorporate subsequent changes which might be made in the federal income tax laws as a basis for future state income tax assessments: "This act in no way undertakes to make future federal legislation a part of the law of this state upon that subject."[66] In reaching this conclusion,

---

[62] Commonwealth v. Warner Bros. Theatres, 345 Pa. 270, 271-72, 27 A. 2d 62, 63 (1942).
[63] 170 Ga. 370, 153 S.E. 58 (1930).
[64] Ga. Const. art III, § 1. The Illinois constitution contains a similar provision. Ill. Const. art IV, § 1.
[65] 170 Ga. at 394, 153 S.E. at 70. (Emphasis added.)
[66] *Id.*

the court relied upon a similar case decided a few years earlier by the sister state of South Carolina where the state income tax was based upon the federal tax as determined under congressional enactments in force at the date the state act became effective.[67]

The Georgia courts had occasion again to consider the question of delegation in a case involving a taxpayer who was subjected to an additional state income tax based upon an additional federal tax assessment made pursuant to a compromise settlement reached with the federal authorities. The Georgia Court of Appeals held against the taxpayer in reliance upon the prior decision in the *Featherstone* case.[68]

As the foregoing cases indicate, there is no question as to the validity of a state income tax based upon the "income" or the "income tax" determined under the Internal Revenue Code as it exists at the date of enactment of the state statute. Another and more important question from the standpoint of practical administration of a state income tax is whether a state statute can properly incorporate future changes in the Internal Revenue Code as a basis for ascertaining the state tax. On the latter point consideration should be given to the decision in *Alaska Steamship Co.* v. *Mullaney,*[69] a more recent case which dealt with the question of delegation under the income tax enacted by the Territory of Alaska.

Under the Alaska statute, a tax was levied for each taxable year upon the net income of every taxpayer equal to "10 percent of the total income tax that would be payable for the same taxable year to the United States under the provisions of the Internal Revenue Code." The statute specifically incorporated by reference the Internal Revenue Code of the United States *"as now in effect or hereafter amended."* The Alaska statute was first subjected to a broadside attack, one of the principal contentions being that incorporation of the Internal Revenue Code as *"hereafter amended"* clearly constituted an improper delegation of legislative authority. The court refused to consider this issue on the ground that since there had been no amendments to the Code subsequent to the enactment of the Alaska statute, the court would be anticipating a constitutional question which might never arise. In resolving the basic question of delegation, it was observed, citing *Featherstone* v. *Norman,* that "the right to incorporate by reference provisions of federal law 'now in effect' cannot be questioned."[70]

Having disposed of the specific issue presented, the court returned to

[67] Santee Mills v. Query, 122 S.C. 158, 115 S.E. 202 (1922). The South Carolina statute which was validated by this decision also imposed a tax in an amount equal to one-third of the federal income tax. The reference therein was to the United States Income Tax Act of November 23, 1921, and acts amendatory thereto "which have been passed and approved prior to the time of the approval of this act."

[68] "The State Revenue Commission, in assessing the tax against McKenney, merely adopted the Federal Method of calculating his net income under the Federal statute as the State's method of accomplishing that result, and properly assessed the tax due to the State as one-third of the amount which he had paid to the United States. Such adoption was not a delegation to the Federal authorities of the State's power to tax." Head v. McKenney, 61 Ga. App. 552, 556, 6 S.E. 2d 405, 407 (1939).

[69] 180 F. 2d 805 (9th Cir. 1950).

[70] *Id.* at 815.

the question relating to the incorporation of the Internal Revenue Code as "hereafter amended" and by dictum indicated that such a provision would not render the statute invalid:

> "We do not overlook the fact that if the words 'or hereafter amended' were dropped from the Act, what remains would, in the long run, be unworkable under the legislative scheme here devised, for if the federal income tax requirements were changed substantially by future amendments, it would be impossible, administratively, to calculate the Alaska income tax merely by dividing the tax shown on the federal return by 10. That is a hypothetical question which conceivably may never arise. . . .
>
> "We think it is far from clear that any invalid delegation is attempted. There are of course many cases which have held attempts by a legislative body to incorporate provisions into its enactments by reference to future acts or amendments by other legislatures, to be invalid. But where it can be said that the attempt to make the local law conform to future changes elsewhere is not a mere labor-saving device for the legislators but is undertaken in order to attain a uniformity which is in itself an important object of the proposed legislative scheme, there are a number of precedents for an approval of this sort of thing. Reciprocal and retaliatory legislation falls in this category. People v. Fire Ass'n. of Philadelphia, 92 N.Y. 311, 44 Am. Rep. 380."[71]

After noting that a number of states impose a minimum state death tax based upon the credit allowed under the federal estate tax (which necessarily incorporates future changes in the Internal Revenue Code),[72] the court made the following concluding observation:

> "The effort of the Alaska legislature to make its territorial income tax machinery conform to the federal act, and to preserve and continue such conformity, makes sense. It makes for convenience to the taxpayer and for simplicity of administration. Cf. Underwood Typewriter Co. v. Chamberlain, 94 Conn. 47, 65, 108 A. 154, 160. A similar coordination has been recommended by students of income tax problems for adoption by the states generally. Since the attainment of this uniformity was in itself a major objective of the Alaska legislature, in enacting that the local law must conform, the Alaska legislature, which alone could make this decision, was itself acting, and was not abdicating its functions, nor, in our opinion, making an invalid delegation to Congress."[73]

It is well established, as indicated in the *Alaska Steamship Co.* decision that an attempt under a state statute to incorporate future legislation of another state or the federal government constitutes an unconstitutional delegation of legislative power. The application of this rule is amply illustrated by the following cases which involved unsuccessful attempts to incorporate future federal legislation or regulation: a Florida statute regulating the citrus fruit industry which provided that fruit should be graded according to standards established by a state commission or, at the option

---

[71] *Id.* at 816. (Footnotes omitted.)

[72] Illinois imposes a minimum death tax based upon the credit allowed under the federal estate tax. Ill. Rev. Stat. c. 120, § 403a (1961). See Brown v. State, 323 Mo. 138, 19 S.W. 2d 12 (1929) (sustaining a tax of this type).

[73] 180 F. 2d 805, 816-17 (Footnotes omitted.)

of the shipper, according to the standards "as now fixed by the United States Department of Agriculture, or as such standards may hereinafter be modified or changed;"[74] an Arkansas statute which required payment of minimum prevailing wages upon public construction projects as "determined by the Secretary of Labor of the United States;"[75] a Maine statute which prohibited the sale of beverages determined to be intoxicating "by federal enactment, or by the decision of the supreme court of the United States, now or hereafter declared;"[76] and a Pennsylvania 44-Hour Week Law which vested administration of the law in the state Department of Labor and Industry but provided that "with respect to any industry whose schedule of hours is established by Federal regulation, the schedule to be fixed by the Department . . . shall conform to the schedule established by any such Federal regulatory body."[77]

As a general observation with respect to the foregoing statutes, it is fair to state that there was lacking that substantial degree of independent legislative judgment ordinarily associated with legislative decisions. By contrast with these cases, it is well established that there is no improper delegation of legislative authority where the legislature imposes a tax to be determined upon the basis of an extraneous fact which may be established by the future legislative act of another government. The decisions relating to statutes imposing reciprocal taxes upon insurance companies best illustrate this point. As early as 1882, in *Home Ins. Co.* v. *Swigert,*[78] the Illinois Supreme Court found little difficulty in sustaining a reciprocal tax upon a foreign insurance company in the face of the contention that the General Assembly had abdicated its legislative functions and surrendered them to the legislature of a foreign state:

> "Where the contingency upon which the ultimate operation of a law is made to depend, consists of . . . the action of some foreign deliberative or legislative body, as is the case here, it is erroneous to suppose the legislature in such case abandons its own legislative functions, or delegates its powers . . . to such foreign deliberative or legislative body. . . . *Nothing is better settled than that the operation* and even remedial character *of a perfect and complete law may, by virtue of limitations contained in the law itself, based upon contingent extrinsic matters, be enlarged, diminished, or wholly defeated.*"[79]

The rule applied in *Home Ins. Co.* is clear, namely, that the legislature can adopt a statute which is operative upon the basis of an extrinsic fact which may be established by the future legislative act of a foreign state, but the court failed to articulate the underlying rationale for its rule. This was left for the New York Court of Appeals in a decision rendered the following year which adhered to the view adopted by the Illinois court.

In the leading and often cited case of *People* v. *Fire Ass'n. of Philadel-*

[74] Hutchins v. Mayo, 143 Fla. 707, 197 So. 495 (1940).
[75] Crowly v. Thornbrough, 226 Ark. 768, 294 S.W. 2d 62 (1956).
[76] State v. Intoxicating Liquors, 121 Me. 438, 117 Atl. 588 (1922). ***Contra,*** Com. v. Alderman, 275 Pa. 483, 119 Atl. 551 (1923).
[77] Holgate Bros. Co. v. Bashare, 331 Pa. 255, 200 Atl. 672 (1938).
[78] 104 Ill. 653 (1882).
[79] *Id.* at 665. (Emphasis added.)

phia,[80] the New York court was similarly concerned with the question of improper delegation under a statute which taxed foreign insurance companies on a recriprocal basis. The principal argument against the validity of the statute was that it did not fix the amount of tax but remitted "it to the legislature of another state by its enactments to create or change the tax." The court responded by expounding upon the "extrinsic fact" rule but without citing the previous Illinois decision:[81]

> "But the whole argument rests on the single point that the amount of the tax . . . imposed is not definitely fixed by the terms of the statute, but depends above a certain rate upon foreign legislation. . . . But in the statute before us nothing is left to anybody's discretion. That is certain which can be rendered certain, and *the act fixes the tax by reference to an extrinsic fact* which determines its amount in excess of a fixed and established rate. *Because that extrinsic fact is the legislation of another state, it does not follow that the legislative discretion of such other state is in any manner substituted for our own. . . . It seems to us that the whole difficulty arises from a failure to regard the foreign law,* relatively to our own legislation, *as simply and purely an extrinsic and contingent fact.*"[82]

At a later point the court expanded upon this doctrine by observing that the fundamental question is one as to whether "legislative judgment" has been exercised in the adoption of the particular statute. To illustrate, it was suggested that there would be an improper delegation of legislative authority if the New York legislature were to adopt a statute which provided that the legal rate of interest should be the same as that prescribed from time to time by the law of Maine. In that case, there would be no exercise of legislative judgment involved since there could be no debate upon the expediency of the particular rate to be charged. The only thing that could be debated would be whether the legislature should abdicate its own judgment and authority.[83] Finally the court concluded that the issue turns on whether the statute was enacted "*because* of the foreign law" or only "*according* to the foreign law":

> "One has merits of its own; the other has not. The expediency of one is debatable; that of the other is not. . . . The one is passed for legislative reasons and out of a legislative discretion which the foreign law and its possible mutations engender, and the other without any such reasons and with no reason whatever, but only through trust in a foreign reason. It seems to us the difference is plain and decisive."[84]

In a subsequent New York case, *People ex rel Pratt* v. *Goldfogle,*[85] a question was presented as to the constitutionality of a statute which subjected to taxation "moneyed capital" other than bank shares coming into competition with the business of national banks. It was the purpose of the

[80] 92 N.Y. 311 (1883).
[81] It should be noted that the Illinois decision in *Home Ins. Co.* was brought to the attention of the New York court by citation in the appellant's brief. 92 N.Y. at 314.
[82] 92 N.Y. at 318-20. (Emphasis added).
[83] *Id.* at 322-23.
[84] *Id.* at 323.
[85] 242 N.Y. 277, 151 N.E. 452 (1926).

statute to tax such property on the same basis as shares of national banks as permitted by federal legislation. The objectors contended that there was an unconstitutional delegation of legislative authority in that "moneyed capital" coming into competition with national banks would change as Congress enlarged or diminished the business which national banks might conduct. The court, relying upon *Fire Ass'n. of Philadelphia,* refused to accept this view as "extreme and untenable":

> "If we are right, . . . that the Legislature had the power to classify the particular kind of property to be taxed by this statute in part by reference to the uses in which it was employed, the exercise of that right would not be invalidated because the use thus described might thereafter be changed or enlarged by custom, usage, or federal statutory provision. The Legislature does not surrender any of its essential and constitutional powers. It declares the taxation, fixes the rate, and describes the property to be taxed, and in doing this we believe it had the right to make its classification and description of the property flexible, so that they would be adjustable to conditions thereafter arising, rather than that it was compelled to adopt a new statute every time that some change in the business to be transacted by national banks was made. The classification and description are complete. The extent of the property to be included within the classification may be changed but that is a minor incident."[86]

On the basis of the foregoing authorities, a reasonably persuasive argument can be made that a state income tax based upon the amount of "income" or the amount of "income tax," determined under the Internal Revenue Code, would be valid whether the statute were to incorporate the Code as it exists at the date of enactment or as thereafter amended. In either case, the legislature prescribes the formula for determination of the tax. The quality of the legislative judgment involved is at least equivalent to that involved in the reciprocal taxing statutes applicable to insurance companies. In the latter, the question is one of determination of burden of the tax upon foreign insurance companies with reference to the burden imposed by another state upon domestic insurance companies. In the case of a state income tax based upon the Internal Revenue Code, the legislative determination of burden is two-fold. One is the determination of the state income tax burden relative to the burden imposed upon the taxpayer under the federal tax. In this respect there is an exercise of legislative judgment whether the statute incorporates the Code only in its existing form, or also as subsequently amended. The second is the exercise of legislative judgment relative to the administrative burden of a state income tax upon both the state and its taxpayers. By a decision to base a state income tax upon the federal code, present and prospective, the legislature would minimize the cost of administration and substantially reduce the burden of compliance imposed upon the taxpayer. As indicated in the *Alaska Steamship Co.* decision, a determination

[86] 242 N.Y. at 292, 151 N.E. at 457.

by the legislature to coordinate a state income tax with the federal would constitute an exercise of substantial legislative judgment.

As a practical matter, however, the question as to the incorporation of future changes in the Internal Revenue Code does not present an insurmountable obstacle to the coordination of a state income tax with the federal. The General Assembly at each session, need only provide for retrospective incorporation of any changes which may have been made in the Internal Revenue Code in the interim years. There would be no violation of due process since the taxpayer could expect the legislature to coordinate the provisions of the state tax with the federal in these circumstances; or, to express the proposition differently, a taxpayer could not reasonably rely upon inaction by the General Assembly in conforming the state tax with the federal.[87] The procedure of retroactively incorporating the changes made in the Internal Revenue Code would be somewhat awkward, but it would not preclude incorporation by reference as a means of simplifying the administration of a state income tax.[88]

It is of interest to note that the New York constitution was amended in 1959 to specifically authorize the incorporation of prospective changes in the federal income tax as a basis for the New York state income tax.[89] The voters of Colorado have recently approved a similar amendment to the constitution of their state.[90]

Conclusion: Under the rule of incorporation by reference, a state income tax could be effectively coordinated with, and based upon, the federal income tax.

C. Occupation, Franchise and Privilege Taxes Measured by Income

1. Corporate Franchise Tax. It has been proposed that consideration be given to changing or supplementing the annual corporate franchise tax which is presently based on stated capital and paid-in surplus by adopting a tax based on net income. The constitutional question presented is one as to whether a tax in this form would be stricken down under the rule of *Bachrach* v. *Nelson*[91] as a tax upon income.

On the basis of the well established distinction between the subject of

---

[87] Welch v. Henry, 305 U.S. 134, 59 Sup. Ct. 121 (1938).

[88] A number of states which conform to the federal income tax follow the practice of amending their statutes from time to time to incorporate, retroactively, interim amendments to the Internal Revenue Code. For example, see the recent amendments of the Iowa income tax to pick up the changes in the Internal Revenue Code during the period December 31, 1960 to December 31, 1962. S.B. 30, approved January 28, 1963. 24 CCH STATE TAX REV. No. 5, February 4, 1963.

[89] The New York provision reads as follows: "Notwithstanding . . . any other provision of this constitution, the legislature, in any law imposing a tax or taxes on, in respect to or measured by income, may define the income on, in respect to or by which such tax or taxes are imposed or measured, by reference to any provision of the laws of the United States as the same may be or become effective at any time or from time to time, and may prescribe exceptions or modifications to any such provision." N.Y. Const. art III, § 22.

[90] At the general election held on November 6, 1962, the voters of Colorado approved the following amendment: "The General Assembly may by law define the income upon which income taxes may be levied . . . by reference to provisions of the laws of the United States in effect from time to time, whether retrospective or prospective in their operation, and shall in any such law provide the dollar amount of personal exemptions to be allowed to the taxpayer as a deduction. The General Assembly may in any such law provide for other exceptions or modifications to any of such provisions of the laws of the United States and for retrospective exceptions or modifications to those provisions which are retrospective." Colo. Const. art X, § 19.

[91] 349 Ill. 579, 182 N.E. 909 (1932).

a tax and the measure of a tax, the *Bachrach* case would be inapplicable and a tax of this type would be sustained as a tax upon the privilege of doing business in the corporate form. The leading case on this point is *Flint* v. *Stone Tracy Co.*[92] which sustained a corporate excise tax enacted by Congress in 1909. With certain exceptions not important here, the statute provided that "every corporation . . . shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation" at the rate of 1% upon all income in excess of $5,000.

One of the principal objections to the statute was premised on the argument that the act imposed a tax upon income contrary to the rule of the *Pollock*[93] decision. The court responded to this argument by emphasizing the distinction between the subject of the tax and the measure of the tax:

> "It is further contended that some of the corporations, notably insurance companies, have large investments in municipal bonds and other nontaxable securities, and in real estate and personal property not used in the business; that therefore the selection of the measure of the income from all sources is void, because it reaches property which is not the subject of taxation—upon the authority of the Pollock Case, supra. *But this argument confuses the measure of the tax upon the privilege with direct taxation of the state or thing taxed.* In the Pollock Case, as we have seen, the tax was held unconstitutional because it was in effect a direct tax on the property solely because of its ownership."[94]

This basic distinction between the subject and measure of a tax has been recognized by the Illinois Supreme Court. In *Winter* v. *Barrett,* which dealt with the first retailers' occupation tax, the court stated:

> "It may be true that in certain instances, as in the case of restaurants selling meals, the price charged for the tangible personal property sold is based largely on the cost of the service given, but that does not show that the tax is not on the business or occupation. *The price charged for articles sold is merely the measure of the tax to be paid in such cases,* as in the case of all other retailers upon whom the tax is imposed. We hold that the tax is not a property tax and is not a tax on purchasers of property but is a tax on persons engaged in the business of selling tangible personal property at retail—an occupation tax."[95]

In view of the long standing acceptance of the distinction between the subject and the measure of a tax,[96] there appears to be little, if any, doubt as to the validity of a corporate franchise tax measured by income.[97] Such a tax, if adopted, would be made applicable, of course, to both domestic and foreign corporations to avoid discriminatory treatment and to equalize the tax burden. Income from interstate business would be allocated to Illinois

[92] 220 U.S. 107, 31 Sup. Ct. 342 (1911).

[93] Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, 15 Sup. Ct. 673, *decision on rehearing,* 158 U.S. 601, 15 Sup. Ct. 912 (1895).

[94] 220 U.S. at 162, 31 Sup. Ct. at 353. (Emphasis added.)

[95] 352 Ill. 441, 456-57, 186 N.E. 113, 121 (1933). (Emphasis added.)

[96] *E.g.,* Home Ins. Co. v. New York, 134 U.S. 594, 10 Sup. Ct. 593 (1890).

[97] It is significant that two major states, Massachusetts and Pennsylvania, which have held net income taxes to be invalid property taxes under their respective constitutional provisions have sustained corporate franchise taxes measured by net income as valid excise or privilege taxes. Alpha Portland Cement Co. v. Comm., 244 Mass. 530, 139 N.E. 158 (1923) ; Turco Paint & Varnish Co. v. Kalodner, 320 Pa. 421, 184 Atl. 37 (1936).

on the basis of a reasonable formula as is presently the case with respect to the annual franchise tax which is based upon an allocation of stated capital and paid-in surplus.[98] A formula which results in a reasonable allocation of income from interstate business would preclude any serious constitutional problem under either the due process or commerce clause.[99]

Conclusion: It is reasonably clear that a corporate franchise tax based upon net income would be sustained as a valid privilege tax.

2. Selected Occupation and Privilege Taxes. Discussions of the current revenue problems in Illinois have brought suggestions for the adoption of additional occupation and privilege taxes measured by income. The plenary power of the General Assembly to select additional occupations for taxation is apparent from the language of Sections 1 and 2 of Article IX of the Illinois Constitution. It need only be observed that the legislature is free in its discretion to expand the base of the state's occupation taxes. The following extract from the decision in *Reif* v. *Barrett,* sustaining the second retailers' occupation tax, provides sufficient confirmation of the legislative power, if indeed confirmation is required:

> "Great latitude is given where that power is not limited, by constitutional inhibition, to the legislative body of the State to classify trades, callings, businesses or occupations and to make them subject to tax for the privilege of following a trade, calling, business or occupation. If the classification is not unreasonable, capricious or arbitrary but rests upon some reasonable consideration of public policy there is no denial of the equal protection of the law. . . . It is not the function of the court to weigh the propriety or expediency of the legislative act or the tax under consideration or to seek for the motives which prompted the passage of the act or the public policy adopted by the legislature in its passage. The court's sole office, if the classification is reasonable and the act is within the power of the legislature to pass and the act does not deny equal protection of the law, is to uphold the validity of the law. *The rule of this court has always been that the legislature has plenary power as to the subjects and objects which it will tax, except in so far, only, as the legislative department is limited by constitutional limitations.* . . . It is the rule of this court that he who challenges the constitutionality of the legislative act has the burden of showing clearly wherein such act violates such limitations."[100]

Although the legislative power to select occupations as a basis for taxation is substantially unlimited, there have been serious doubts since the *Bachrach* decision as to whether privileges unrelated to a trade, calling, business or occupation could be made the subject of a tax. For example, could the General Assembly select the privilege of investing, or the privilege of receiving interest and dividends, as the subject of a tax measured by

[98] Under the present statutory provisions, stated capital and paid-in surplus are allocated to Illinois on the basis of property in the State and gross receipts from business transacted in the state to total property and gross receipts of the corporation. Ill. Rev. Stat. ch. 32, § 157.132 (domestic corporations) and § 157.136 (foreign corporations) (1961).

[99] *E.g.*, Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 79 Sup. Ct. 357 (1959); Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 41 Sup. Ct. 45 (1920).

[100] 355 Ill. 104, 118-19, 188 N.E. 889, 896 (1933). (Emphasis added.)

income and thus reach the income from intangible property? Doubts on this point have been substantially resolved by the subsequent use tax decisions and the broad concept of taxable privilege adopted in *Johnson* v. *Halpin*[101] and *Turner* v. *Wright*.[102] The position taken by the court in the use tax cases conforms with the mandate of Section 2, Article IX which provides that "the specification of the objects and subjects of taxation shall not deprive the General Assembly of the power to require other subjects or objects to be taxed, in such manner as may be consistent with the principles of taxation fixed in this Constitution." Since these decisions have been discussed at considerable length in another portion of this report, there is no need to elaborate upon these cases at this point.[103]

Conclusion. Within the limits of the uniformity requirements, the General Assembly possesses plenary power to select additional occupations, businesses and privileges as subject of taxation measured by income.

3. General Occupation and Privilege Tax. If it were decided that the state should substantially expand its occupation and privilege taxes, this decision could be implemented by the selection of numerous additional specific occupations, businesses and privileges as the subject of taxation. Legislatively, this is a cumbersome approach. An alternative would be the enactment of a comprehensive occupation and privilege tax to embrace all occupations, businesses and privileges, the tax to be measured by income.

A comprehensive occupation and privilege tax based upon income presents two constitutional questions. The first is whether a tax can be imposed with respect to the privilege of receiving income where the taxpayer is not engaged in an occupation, trade, or business. This question is the same as that considered under the preceding topic and, as indicated therein, this issue has been resolved by the use tax decisions.

The second question which arises with respect to a general occupation and privilege tax is whether the classification would be reasonable under the uniformity requirements of Section 1, Article IX. It is acknowledged that occupation and privilege taxes can be imposed upon selected subjects and objects. If the General Assembly can tax any and all occupations, businesses and privileges on a selected basis, may it not tax them on a collective basis under a comprehensive statute? Could the General Assembly adopt an all embracing tax on occupations, businesses and privileges and specifically exempt certain selected occupations without violating the uniformity requirements? For example, could the General Assembly enact a comprehensive occupation and privilege tax, but exempt from the general tax those occupations and privileges taxed under other revenue measures such as the retailers' occupation tax, etc.? Would this not be the same as selecting some occupations and privileges for one tax and selecting other occupations and

[101] 413 Ill. 257, 108 N.E. 2d 429 (1952), *cert. denied*, 345 U.S. 923, 73 Sup. Ct. 781 (1953).
[102] 11 Ill. 2d 161, 142 N.E. 2d 84 (1957).
[103] See text at p. 366 *supra*.

privileges for other taxes which the General Assembly is presently free to do?

On the question of classification, there seems to be little doubt as to the validity of a carefully drafted general occupation and privilege tax. Through the years, the Illinois Supreme Court has stated its adherence to the rule of broad legislative discretion in classification for tax purposes. The Court has demonstrated the vitality of this rule in such recent decisions as *Bode* v. *Barrett*[104] and *Peoples Gas Co.* v. *City of Chicago*,[105] and particularly in the more recent decision in *People ex rel Holland Coal Co.* v. *Isaacs*.[106] As indicated in the footnotes, these cases are discussed at length elsewhere in this report and there is no purpose in repeating the discussion at this point.

Conclusion: A comprehensive general occupation and privilege tax measured by income would be valid under Article IX of the Illinois Constitution.

D. Occupation Franchise and Privilege Taxes—Rates, Credits, Exemptions and Deductions

1. Graduated Taxes. In the consideration of proposals for expanding the state revenues, a question has arisen as to whether the General Assembly could validly enact graduated occupation, franchise and privilege taxes. This question is particularly pertinent in view of the several Illinois cases sustaining revenue measures which have imposed some type of graduated tax.

The constitutional question with respect to a graduated tax is one of uniformity under the second clause of Section 1, Article IX. Is there a reasonable basis for the separate classifications created by the adoption of exemptions and the imposition of graduated rates? The most notable example of a graduated tax is the Illinois inheritance tax which was sustained in *Kochersperger* v. *Drake*.[107] The principal objection to the tax was based on an alleged violation of the uniformity requirements by reason of the rates and exemptions which varied depending upon the relationship of the beneficiary to the decedent. In sustaining the tax, the court observed that the General Assembly has plenary power over the devolution of property at death: "No person inherits property or can take by devise except by the statute, and the State, having power to regulate this question, may create classes and provide for uniformity with reference to classes which were before unknown."[108] The court, in effect, held that inasmuch as the General Assembly possessed the power to abolish the inheritance of property, it could impose any conditions which it might see fit upon the enjoyment of the privilege. With respect to the classifications adopted by the legislature, the court stated:

---

[104] 412 Ill. 204, 106 N.E. 2d 521, *aff'd.* 344 U.S. 583, 73 Sup. Ct. 468 (1952). See text at p. 355 *supra.*

[105] 9 Ill. 2d 348, 137 N.E. 2d 330 (1956). See text at p. 356 *supra.*

[106] 22 Ill. 2d 477, 176 N.E. 2d 889 (1961). See text at p. 398 *infra.*

[107] 167 Ill. 122, 47 N.E. 321 (1897), *aff'd. sub nom.* Magoun v. Illinois Trust and Sav. Bank, 170 U.S. 283, 18 Sup. Ct. 594 (1898).

[108] 167 Ill. at 128, 47 N.E. at 322.

"By this act of the legislature six classes of property are created heretofore absolutely unknown. It is those classes of property depending upon the estate owned by one dying possessed thereof which the State may regulate as to its descent and the right to devise. *The tax assessed on classes thus created is absolutely uniform on the classes upon which it operates. . . .*[109]"

Chronologically, the next case dealing with the question as to the validity of a graduated tax is *Metropolis Theatre Co.* v. *Chicago*.[110] In this case, the court sustained a municipal ordinance, enacted as a revenue measure, which imposed annual license fees upon theatres graduated on the basis of the highest admission charge:

Highest Admission Charge	Annual License Fee
$1 or more	$1,000
More than 50 cents; less than $1	400
More than 30 cents; less than 50 cents	300
More than 20 cents; less than 30 cents	250
Not more than 20 cents	200

In sustaining the statute in the face of the contention that there was a violation of the uniformity requirements of Section 1, Article IX, the court observed:

"Classification of subjects for taxation may not be made arbitrarily, but necessarily there must be great freedom of discretion, even though it result in ill-advised, unequal and oppressive legislation. (*Heath* v. *Worst*, 207 U.S. 338). A classification will be sustained where it is based upon a reasonable difference of situations or conditions. (*Bessette* v. *People*, *supra; Douglas* v. *People*, 225 Ill. 536.) The classification of theaters made by the ordinance in question is based upon a difference in the charge of admission. Under this ordinance every person desiring to give an entertainment is left free to fix the charge of admission as he sees fit. He may thus elect into which class he desires to be placed. Presumably, each person will select the class which will best promote his interests. It may be possible that this basis of classification is not the most equitable that could be devised, but, as was said by the United States Supreme Court in *State Railroad Tax case*, 92 U.S. 575: 'Perfect equality and perfect uniformity of taxation as regards individuals or corporations, or the different classes of property subject to taxation, is a dream unrealized'."[111]

The decision in *Metropolis Theatre Co.* was followed by *McGrath* v. *City of Chicago*[112] which sustained a graduated municipal tax upon furniture-movers. The ordinance was applicable only to those persons operating vehicles with an inside floor surface of more than forty-five square feet. The tax was graduated with respect to the number of vehicles operated by the taxpayer: $100 for those operating one to five vehicles; $200 for those operating six to ten vehicles; with increases of $100 for each additional five

[109] 167 Ill. at 127, 47 N.E. at 322. (Emphasis added.)
[110] 246 Ill. 20, 92 N.E. 597 (1910), *aff'd*, 228 U.S. 61, 33 Sup. Ct. 441 (1913).
[111] 246 Ill. at 24-25, 92 N.E. at 599-600.
[112] 309 Ill. 515, 141 N.E. 299 (1923).

vehicles operated by the taxpayer, the highest tax being $1,100 upon those taxpayers operating more than fifty vehicles. The court was confronted with two objections, both of which challenged the validity of the tax under the uniformity requirements. The first was that the exemption of furniture-movers who operated vehicles having a floor surface less than forty-five square feet was arbitrary. To this argument the court responded as follows:

> "*Just why the city council fixed the division line at forty-five square feet of floor surface we are not advised, nor is it necessary that the council give its reasons for making the classification as it did.* It no doubt took into consideration that most vehicles used in the business of moving furniture have an inside floor surface of more than forty-five square feet, that the heavier vehicles do more damage to the streets than the smaller ones, and that the larger vehicles produce a larger income than those of less capacity. *It is not possible, nor is it necessary, in a classification for governmental purposes that there be an exact exclusion or inclusion of persons and things.* . . . It cannot be said that there are not reasonable grounds for including within the ordinance those operating vehicles with a floor surface of more than forty-five square feet and excluding therefrom smaller vehicles. . . .[113]"

The second objection in *McGrath* was directed at the graduated rates provided in the ordinance. On this point, the court expressed concern as to the apparent inequity arising from the fact that the owner of six vehicles would pay double the tax paid by one who owned only five. The court, however, relying upon the *Metropolis Theatre Co.* decision, concluded that the classification should be sustained:

> "The city council undoubtedly had the power to create a tax upon the occupation of furniture-moving and to require all persons engaged in that business to pay the tax, regardless of the amount of business done or the number of vehicles employed. It also had the power to fix an occupation tax proportioned exactly to the number of vehicles used, requiring a certain tax to be paid for each vehicle. If these powers be conceded, then it seems to be sound to hold that the city council had power to create an occupation tax graded according to the number of vehicles employed, by dividing the persons engaged in the occupation into groups. While men may differ with the city council with respect to the justice of the classification made by it, it seems clear that it was acting within the powers delegated to it, and we are not able to say that its action is so arbitrary and unreasonable as to render the ordinance invalid."[114]

The most recent case to involve a graduated tax is that of *Bode* v. *Barrett*[115] in which the court sustained an annual license tax imposed under the Motor Vehicle Law which was graduated according to gross weight, including the weight of the vehicle and the maximum load. The classifications under the statute were sustained on the ground that the license fees so imposed served to equalize the taxes paid per ton-mile for the privilege of using the state roads.

---

[113] 309 Ill. at 517-18, 141 N.E. at 300. (Emphasis added.)
[114] 309 Ill. at 519-20, 141 N.E. at 300.
[115] 412 Ill. 2d 204, 106 N.E. 2d 521 (1952).

Although these decisions accord to the legislature broad discretionary power in the enactment of graduated taxes, there is nevertheless a limitation upon legislative discretion. It is impossible to precisely define this limit, for the reasonableness of the classifications created by a graduated tax, as in other cases, is one of degree. The question of particular current interest relates to graduated occupation and privilege taxes based upon income. Inasmuch as the application of graduated rates to net income is a well established practice under the fiscal systems of the federal government and a number of sister states, there is little doubt as to the validity of graduated occupation and privilege taxes measured by net income.[116] The classifitions resulting from a graduated tax computed upon net income are deemed reasonable in relation, not only to the taxpayers' ability to pay, but also to the benefits and protection enjoyed under the laws of the state.[117] A number of state courts have dealt with this question and with a substantial degree of unanimity have held that graduated rates withstand the requirements of reasonable classification. The Missouri court, relying upon decisions from a number of states, has provided one of the most comprehensive statements on the question:

> "The statutory classification puts net income into narrow brackets, and then applies to each successive bracket after the first, in an ascending scale, a rate of taxation slightly larger than the rate applicable to the preceding bracket. Is such classification invalid, because arbitrary and unreasonable? It is similar to the classifications upon which rest all systems of income taxation having a progressive feature. The basic principle underlying all such classifications is the ability of the taxpayer to pay. Many economists and students of government regard a progressive tax as more just and equal in point of sacrifice than a proportional one, since persons with large incomes can more readily spare a fixed proportion of their income than those who have difficulty in sustaining themselves upon what they receive each year. This is the fundamental idea carried forward in all schemes for the taxing of incomes in which there is a progressive graduation of the tax, including that of the United States and those of the states of Arkansas, Delaware, Georgia, Idaho, Mississippi, New York, Oregon, North Dakota, and South Carolina. See in re Income Tax cases, 148 Wis. 456, 134 N.W. 673, 135 N.W. 164; Featherstone v. Norman, 170 Ga. 370, 153 S.E. 58, 70 A.L.R. 449; Diefendorf v. Gallet, 51 Idaho 619, 10 P. (2d) 307; Standard Lbr. Co. v. Pierce, 112 Or. 314, 228 P. 812; State ex rel. Knox v. Gulf, M & N. Railroad, 138 Miss. 70, 104 So. 689; Stanley v. Gates, 179 Ark. 886, 19 S.W. (2d) 1000; Knowlton v. Moore, 178 U.S. 41, 20 S. Ct. 747, 44 L. Ed. 969; Flint v. Stone Tracy Co., 220 U.S. 107, 31 S. Ct. 342, 55 L. Ed. 389, Ann. Cas. 1912B, 1312. In view of the general acceptation of

---

[116] As of September 1, 1962, 32 states had adopted a general income tax applicable to individuals and 31 of these employed a graduated rate schedule. TAX FOUNDATION, FACTS AND FIGURES ON GOVERNMENT FINANCE, Tables 141 and 142, p. 189-91 (12th ed. 1962-1963).

[117] "Income taxes are a recognized method of distributing the burdens of government, favored because requiring contributions from those who realize current pecuniary benefits under the protection of the government, and because the tax may be readily proportioned to their ability to pay." Shaffer v. Carter, 252 U.S. 37, 51, 40 Sup. Ct. 221, 225 (1920).

the principle, classifications based upon ability to pay cannot for that reason alone be said to be capricious or whimsical."[118]

In subsequent cases, the courts of several additional states have joined in this view.[119]

By contrast, it is highly unlikely that a graduated tax based upon gross income would be sustained. The leading case on this point is *Stewart Dry Goods Co.* v. *Lewis.*[120] In this case a Kentucky gross sales tax which was imposed on a graduated basis was held unconstitutional on the ground that there was an unreasonable classification contrary to the equal protection clause of the fourteenth amendment. The rates were graduated from 1/20th of one percent on the first $400,000 of gross sales to one percent on gross sales in excess of $1,000,000.

The Court stated the question as follows: "Does the act tax sales in an unequal and arbitrary way, classifying them for the imposition of different rates without reference to any real or substantial distinction . . . or does it impose an excise upon the conduct of retail business, reasonably adjusted in amounts with regard to substantial differences in the nature of the privilege exercised . . .?"[121] The Court's principal concern was with the fact that the graduated rates would result in taxing a sale of identical goods at the same price at a different rate depending upon the total volume of the vendor's transactions.

In an attempt to persuade the Court to distinguish between the subject and the measure of the tax, it was argued that the tax should be treated as an excise upon the privilege of retail merchandising measured by gross receipts. It was further argued that in these circumstances there was a reasonable relationship between the amount of the tax and the privilege for which the tax was imposed in that a merchant's net income and his ability to pay increased with the volume of his sales. In response, the Court stated that "the argument does not advance the case for validity of the statute. Even in this aspect the classification is arbitrary, for the claimed relation of gross sales—the measure of the tax—to net profits fails to justify the discrimination between taxpayers."[122] The court was primarily concerned with the economic effect of the tax and the question as to whether a graduated gross receipts tax was reasonably related to the net profits of a business. On this point, the Court observed:

" 'The difference in effect between a tax measured by gross receipts and one measured by net income, recognized by our decisions, is manifest and substantial, and it affords a convenient and workable basis of distinc-

[118] Bacon v. Ransom, 331 Mo. 985, 994-95, 56 S.W. 2d 786, 789 (1932).

[119] Reed v. Bjornson, 191 Minn. 254, 253 N.W. 102 (1934); O'Connell v. State Board of Equalization, 95 Mont. 91, 25 P. 2d 114 (1933); State *ex rel* Haggart v. Nichols, 66 N.D. 355, 265 N.W. 859 (1936). *But see* Kelley v. Kalodner, 320 Pa. 180, 181 Atl. 598 (1935). In the *Kelley* case, the Pennsylvania court held that an income tax was, at least in part, a property tax and that the graduated rates violated the rule of uniformity. In an earlier case, a flat rate 2% inheritance tax upon personal property with an exemption of the first $5,000 was held invalid as violating the uniformity provisions. In re Cope's Estate, 191 Pa. 1, 43 Atl. 79 (1899).

[120] 294 U.S. 550, 55 Sup. Ct. 525 (1935).

[121] 294 U.S. at 555, 55 Sup. Ct. at 527.

[122] 294 U.S. at 558, 55 Sup. Ct. at 528.

tion between a direct and immediate burden upon the business affected and a charge that is only indirect and incidental. A tax upon gross receipts affects each transaction in proportion to its magnitude and irrespective of whether it is profitable or otherwise. Conceivably it may be sufficient to make the difference between profit and loss, or to so diminish the profit as to impede or discourage the conduct of the commerce. A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and losses, and the tax cannot be heavy unless the profits are large.'

"Argument is not needed, and indeed practical admission was made at the bar, that the gross sales of a merchant do not bear a constant relation to his net profits; that net profits vary from year to year in the same enterprise; that diverse kinds of merchandise yield differing ratios of profit; and that gross and net profits vary with the character of the business as well as its volume."[123]

In concluding that a graduated gross receipts tax was invalid, the Court was confronted with the necessity of distinguishing its prior decisions in which it had sustained graduated chain store taxes:

"In several recent cases we sustained the classification of chain stores for taxation at rates higher than those applicable to single stores, and graduated upward on each store as the total number of units in one ownership increased. We found this classification reasonable because of advantages incident to the conduct of multiple stores and obvious differences in chain methods of merchandising as contrasted with those practiced in the operation of one store. The instant cases present a classification of quite another kind. The Kentucky statute ignores the form of organization and the method of conducting business. The taxable class is retail merchants, whether individuals, partnerships, or corporations; those who sell in one store or many; those who offer but one sort of goods and those who through departments deal in many lines of merchandise. The law arbitrarily classifies these vendors for the imposition of a varying rate of taxation, solely by reference to the volume of their transactions, disregarding the absence of any reasonable relation between the chosen criterion of classification and the privilege the enjoyment of which is said to be the subject taxed. It exacts from two persons different amounts for the privilege of doing exactly similar acts because the one has performed the act oftener than the other."[124]

The Court also found it necessary to distinguish the decision in *Metropolis Theatre Co.* which had been affirmed upon appeal as meeting the reasonable classification requirements of the equal protection clause. In making the distinction, the Court observed that the price of admissions charged by a theatre was reasonably related to the ultimate profit of the business. On this basis, the Court concluded that the *Metropolis Theatre Co.* case "furnishes no support for a tax upon the sales of merchants at rates varying per sale or per dollar with the amount of their respective gross sales."[125] It is submitted that the underlying rationale of the *Stewart Dry Goods Co.* decision would prove equally persuasive in the application of the uniformity pro-

[123] 294 U.S. at 558-59, 55 Sup. Ct. at 528-29.
[124] 294 U.S. at 565-66, 55 Sup. Ct. at 532.
[125] 294 U.S. at 565, 55 Sup. Ct. at 531.

visions of the second clause of Section 1, Article IX of the Illinois Constitution.

Conclusion: Reasonably graduated occupation and privilege taxes measured by net income, as contrasted with gross receipts or gross sales, would be valid under Section 1 of Article IX.

Historical Note

Discussion of the question as to the validity of a graduated excise tax would be incomplete if the role of the State of Illinois in the constitutional development of graduated taxes were not fully noted. Reference has previously been made to the *Kochersperger* case which sustained the Illinois Inheritance Tax Act of 1895 with varying exemptions and graduated rates against the contention that the statute violated the uniformity requirements of the second clause of Section 1 of Article IX. The *Kochersperger* case was subsequently appealed to the United States Supreme Court on the ground that the graduated features of the inheritance tax were contrary to the requirement of reasonable classification under the equal protection clause of the fourteenth amendment. This was the first case to present to the Court the question as to whether a tax imposed at graduated rates violated provisions of the federal constitution.[126]

In *Magoun* v. *Illinois Trust & Sav. Bank,*[127] the Court, with but one dissent, sustained the graduated rates as consistent with the rule of equality:

> "That rule does not require, as we have seen, exact equality of taxation. It only requires that the law imposing it shall operate on all alike, under the same circumstances."[128]

Thus the Court found that the Illinois inheritance tax was neither arbitrary because it was graded and determined by value nor unequal in operation because it did not levy the same percentage on every dollar value of an inheritance.

The decision in *Magoun* was followed three years later by *Knowlton* v. *Moore*[129] which sustained a graduated federal legacy tax. In *Knowlton*, the court expanded upon its views in the *Magoun* decision with the following observations:

> "The review which we have made exhibits the fact that taxes imposed with reference to the ability of the person upon whom the burden is placed to bear the same have been levied from the foundation of the government. So, also, some authoritative thinkers, and a number of economic writers, contend that a progressive tax is more just and equal than a proportional one. In the absence of constitutional limitation, the question whether it is or is not is legislative and not judicial. The grave consequences which it is asserted must arise in the future if the right to levy a progressive tax be recognized involves in its ultimate aspect the mere assertion that free and representative government is a failure, and

[126] Although the Court had not previously considered the validity of a graduated tax, Congress, almost a century before, had enacted a direct tax on dwellings at rates which were graduated from 2/10 of 1% on the first $400 of taxable value to 1% upon values in excess of $30,000. 1 Stat. 594 (1798).

[127] 170 U.S. 283, 18 Sup. Ct. 594 (1898).

[128] 170 U.S. at 300, 18 Sup. Ct. at 601.

[129] 178 U.S. 41, 20 Sup. Ct. 747 (1900).

> that the grossest abuses of power are foreshadowed unless the courts usurp a purely legislative function. If a case should ever arise, where an arbitrary and confiscatory exaction is imposed bearing the guise of a progressive or any other form of tax, it will be time enough to consider whether the judicial power can afford a remedy by applying inherent and fundamental principles for the protection of the individual, even though there be no express authority in the Constitution to do so."[130]

Although federal income, gift and estate tax rates have long since reached confiscatory levels, the decisions in *Magoun* and *Knowlton* remain as a firm foundation for the general validity of graduated taxes under the federal constitution.[131] It is of interest to note that the Illinois Inheritance Tax Act of 1895 proved to be the genesis of this constitutional principle.

2. Credit for Property Taxes. Current proposals to expand the state tax base have been prompted by concern with the constantly increasing burden of the local property tax. This has led to the suggestion that, if the state were to adopt new taxes based upon income, consideration should be given to the allowance of a credit for all or part of the property taxes paid by the taxpayer to local governmental units. In this connection, it should be noted that the income tax enacted in 1932, and declared unconstitutional in *Bachrach v. Nelson*,[132] provided a credit on a proportional basis for property taxes paid upon income-producing property and a credit not to exceed $100 for property taxes paid upon property owned and occupied by the taxpayer as a residence.[133]

The proposal that a credit be allowed against a state tax for local property taxes paid by the taxpayer presents two constitutional questions: (1) Would the allowance of a credit violate the uniformity requirements of Section 1, Article IX? (2) Would a credit contravene the prohibition in Section 6, Article IX against the release or commutation of state taxes?

The second clause of Section 1 of Article IX relating to occupation, franchise and privilege taxes provides that a tax enacted pursuant thereto must be "uniform as to the class upon which it operates." If a credit were allowed for local property taxes paid by the taxpayer, not all taxpayers would be in a position to claim the credit. Some taxpayers, for example, subject to a state tax based on income might not own property subject to local property taxes. On the other hand, some taxpayers paying local property taxes might not have income subject to the state tax. In neither case could the taxpayer benefit from the credit. The fact that these situations would occur in the operation of the credit, however, would not violate the principle of uniformity. The purpose of the credit would be to alleviate the double burden aspect of local property taxes combined with a state tax based on income. The credit would be a reasonable means of accomplishing this

---

[130] 178 U.S. at 109-10, 20 Sup. Ct. at 774.

[131] The graduated features of the first income tax enacted following the adoption of the sixteenth amendment were summarily sustained on the basis of *Knowlton* v. *Moore*. Brushaber v. Union Pac. R. R. Co., 240 U.S. 1, 24, 36 Sup. Ct. 236, 244 (1916).

[132] 349 Ill. 579, 182 N.E. 909 (1932).

[133] Ill. Laws 1st Spec. Sess. 1931-32, at 91.

objective and it would operate uniformly as to each taxpayer in a position to claim the credit—i.e., those taxpayers subject to the state tax who also pay local property taxes.

A comparable question of uniformity was presented at an early date in connection with the classifications adopted in the Illinois Inheritance Tax Act.[134] It was contended that the statute violated the uniformity requirements of Section 1, Article IX by reason of the exemptions and graduated rates provided therein which varied depending upon the relationship of the beneficiary to the decedent. Two persons might receive equivalent amounts as a legacy, but the tax thereon would differ depending upon the relationship of each legatee to the decedent. Similarly, under the proposed credit, two individuals might have the same amount of income upon which a state tax would be determined, but their ultimate tax liabilities would differ depending upon the amount of local property taxes which each would have paid. In resolving the question of uniformity under the Illinois inheritance tax, the court in *Kochersperger* v. *Drake*[135] emphasized the fact that the legislature had defined separate classes and that the varying rates and exemptions operated uniformly within each of the several classes:

> "That statute provides [that] certain classes of property which were a part of an estate shall be exempt from taxation under these provisions, and when the legislature provides other classes of property, some of which shall pay one dollar per hundred, others two, others three and others four, and still others five, and again others six dollars per hundred, six different classes are created, under and by which a tax is levied by valuation on the right of succession to a separate class of property. The class on which a tax is thus levied is general and uniform, and pertains to all species of property included within that class. A tax which affects the property within a specific class is uniform as to that class, and there is no provision of the constitution which precludes legislative action from assessing a tax on that particular class."[136]

The specific question as to violation of the rule of uniformity has arisen under the Missouri income tax where an offsetting credit was allowed for property taxes paid by the taxpayer.[137] Article X, Section 3 of the Missouri Constitution of 1875 stated the rule of uniformity in substantially the same terms as the Illinois provision: "They [taxes] shall be uniform upon the same class of subjects within the territorial limits of the authority levying the tax. . . ." In sustaining the credit as consistent with the principle of uniformity, the Missouri Supreme Court in *Ludlow-Saylor Wire Co.* v. *Wollbrinck*[138] emphasized the fact that the provision was prompted by legislative concern as to the overall burden of taxes:

---

[134] Ill. Laws 1895, at 301.

[135] 167 Ill. 122, 47 N.E. 321 (1897), *aff'd sub nom.* Magoun v. Illinois Trust & Sav. Bank, 170 U.S. 283, 18 Sup. Ct. 594 (1898)

[136] 167 Ill at 127, 47 N.E. at 322.

[137] Mo. Laws 1917, at 524, § 32: "Any person, corporation, joint-stock company, association or insurance company who shall have paid a tax assessed upon his real or personal property to the state during any year shall be permitted to exhibit the receipt or receipts thereof to the assessor to the full amount in the payment of income taxes assessed against such person, corporation, joint-stock company, association or insurance company during said year."

[138] 275 Mo. 339, 205 S.W. 196 (1918).

"The Legislature might well create a class consisting of persons whose income taxes exceeded those paid on their real and personal property, for the reason that persons belonging to such a class occupy a relation of support to the state reasonably distinguishable from others who pay taxes only on their incomes. Hence, by taxing the former to the extent their income taxation exceeded their property taxation, the Legislation intended to distribute with greater equality and justice the different burdens imposed on the whole body of taxpayers, and designed also to encourage and foster the payment of taxes on tangible and specific property by assigning such taxpayers to a distinct class in the imposition of income taxes, that being a subject of taxation within the control of the Legislature, except that, in any event, a tax on income must bear equally upon every person belonging to the same class. This equality of burden, among the members of any of the different classes recognized in the act, applies to those forming the class designated in Section 32 of the Act under review."[139]

Although a credit for property taxes would not violate the rule of uniformity, there is serious doubt as to whether such an allowance would square with the constitutional restriction upon the release or commutation of State taxes imposed by Article IX, Section 6:

"The General Assembly shall have no power to release or discharge any county, city, township, town or district, whatever, or the inhabitants thereof, or the property therein, from their or its proportionate share of taxes to be levied for State purposes, nor shall commutation for such taxes be authorized in any form whatsoever."

This provision and the companion provision in Section 7 of Article IX that "all taxes levied for State purposes shall be paid into the State treasury" were new to the Constitution of 1870 and were added only after vigorous debate in the constitutional convention.

As developed in the debates, Sections 6 and 7 were aimed directly at the practice by which the General Assembly had from time to time commuted or remitted state property taxes assessed in particular taxing districts to finance public improvements. One example cited upon the convention floor was based upon the decision in *People ex rel Becker* v. *Miner*[140] in which the Supreme Court had sustained an act in which the General Assembly directed that state property taxes assessed in certain townships of St. Clair County be paid over to a board of improvements for a period of five years to finance the construction and maintenance of levees on the Mississippi River. The decision had been rendered in 1868 and, although the act was sustained under the provisions of the Constitution of 1848, the court expressed concern as to the policy of this kind of legislation:

"It is further insisted by the Attorney General, that unless some certain amount be appropriated, and to be drawn from the treasury, it would be impossible to know at the time of the enactment, what the State tax would be in the specified townships for the ensuing five years, and should legislation of this kind be sustained, the taxes would soon be paid in

[139] 275 Mo. at 358-59, 205 S.W. at 200.
[140] 46 Ill. 384 (1868).

receipts, signed by presidents and secretaries of all kinds of companies that may be fortunate enough to get the State tax to be collected in certain districts, granted or appropriated to them.

"This is a strong argument against the policy of such legislation, but it leaves the power untouched. The power may be abused, but judging from the past, it is not likely to be in this particular. We again repeat, it is unwise, unsafe and very loose legislation, but are unable to say it is in violation of the constitution. The sum and substance of this act, is a direction to the collector of the taxes in these townships, on a proper certificate being presented to him, to pay the money to the treasurer of this Improvement Company instead of to the State treasury, and on so doing, he shall have credit with the Auditor on his annual settlement, for taxes collected. We see nothing in the constitution so plainly and palpably prohibiting this species of legislation, as to require us to say it is in violation of that instrument, unsafe, loose and dangerous as it is."[141]

There have been relatively few cases through the years dealing with Sections 6 and 7 of Article IX of the Constitution of 1870. Shortly after its adoption, two cases were decided which involved the diversion of State property taxes for local improvements. In one, state taxes levied on certain real estate in Randolph County were diverted to the improvement of navigation upon the Kaskaskia River.[142] In the other, a portion of the state property taxes imposed upon the inhabitants of certain municipalities were to be applied to the payment of the bonded railroad debt previously incurred by the municipalities.[143] In each case, it was held that there was a violation of the prohibition in Section 6 upon the commutation of state taxes.

Later, it was held that a statute which provided for the payment of high school tuition from the state school fund for the benefit of eighth grade graduates in districts not maintaining high schools constituted an invalid release or commutation of state taxes. The court's position was expressed as follows:

"The effect of the act is to exempt owners of property in districts not providing four years of recognized high school work from paying taxes proportionate to the value of their taxable property as compared with the taxable property of other districts, to the extent that the State tax is appropriated to a local and corporate purpose. The result is to release the districts from the payment of taxes for such purpose, and that is a violation of section 6 of article 9 of the constition, which provides that the General Assembly shall have no power to release or discharge any county, city, township, town or district whatever, or the inhabitants thereof or the property therein, of their or its proportionate share of taxes to be levied for State purposes, nor shall commutation for such taxes be authorized in any form whatsoever. The statewide school tax is a tax for a State purpose, to be apportioned to and distributed by the Auditor among the districts in the county, and by the act in question the school district maintaining no high school is released from taxation for the local and corporate purpose of paying tuition of its pupils re-

[141] 46 Ill. at 390.
[142] People *ex rel* Kaskaskia River Nav. Co. v. Lippincott, 65 Ill. 548 (1872).
[143] Ramsey v. Hoeger, 76 Ill. 432 (1875).

siding in the district and attending schools outside of the district."[144]

In more recent years, the "Scavenger Act" which establishes a tax sale procedure for removing the lien of taxes on property delinquent for ten years or more was challenged on the ground that it authorized a release of taxes contrary to the restrictions of Section 6. In *Schreiber* v. *County of Cook,*[145] the court observed that a release is effected by voluntary act and concluded that there was no violation of Section 6 since the extinguishment of the lien of delinquent taxes is effected by judicial sale.

The most recent case involving Section 6 was *Turner* v. *Wright*[146] which sustained the Use Tax Act. There it was held that Section 6 of Article IX was not violated by the provision which relieves the retailer of remitting the use tax collected from the purchaser to the extent that the retailer remits the amount due on the same transaction under the retailers' occupation tax. The court emphasized the fact that this procedure was merely a method by which the two taxes were integrated and that there was in fact no release or commutation of state taxes.

The proposal to grant a credit against a state tax for local property taxes paid by the taxpayer would clearly permit the payment of local property taxes to serve in lieu of a payment of state taxes. To the extent of the credit, there would be a substitution of one for the other—a "commutation" within the ordinary meaning of the term. Unless the language of Section 6 were to be narrowly limited, the proposed credit would appear to violate the constitutional prohibition.

It has been suggested that Section 6 should be construed to apply only to those situations involving the release or commutation of state taxes imposed upon an entire taxing district.[147] This suggestion has been premised on the following language in *Schreiber* v. *Cook County*:

> "That section of the constitution [Section 6, Article IX] applies only to the prohibition of any release or commutation of State taxes. (*Raymond* v. *Hartford Fire Ins. Co.* 196 Ill. 329.) *The evil prevailing at the time of adoption of the 1870 constitution, which that section was intended to prevent, was the release and commutation of State taxes for an entire taxing unit.* (*Raymond* v. *Hartford Fire Ins. Co.* 196 Ill. 329.) *The property of the whole taxing district was in contemplation when the section was adopted.*"[148]

If the restriction in Section 6 were to be applied in this limited manner, the proposed credit would be valid inasmuch as it is highly improbable that there would be a one hundred percent offset of local property taxes against the state tax in any particular taxing district.

Although the language in the first part of Section 6 may reasonably be construed to apply in this manner, it is doubtful that this narrow construction would prevail in the face of the concluding clause: *"nor shall commuta-*

[144] Bd. of Educ. v. Haworth, 274 Ill. 538, 545, 113 N.E. 939, 942 (1916).
[145] 388 Ill. 297, 58 N.E. 2d 40 (1944).
[146] 11 Ill. 2d 161, 142 N.E. 2d 84 (1957).
[147] Note, 46 Ill. L. Rev. 100, 101 n. 5 (1951).
[148] 388 Ill. at 304, 58 N.E. 2d at 44. (Emphasis added.)

tion for such [State] *taxes be authorized in any form whatsoever.*" In *Raymond* v. *Hartford Fire Ins. Co.* the court made the following observation with respect to the construction to be placed upon Section 6:

> "We do not mean to say that the last clause of Section 6, forbidding commutations of State taxes in any form, has no broader significance than the first clause forbidding the release or discharge of any district of the State, or its inhabitants or property, from its or their proportionate share of State taxes, but only that that was deemed a form of commutation and a prevalent evil chiefly intended to be guarded against. (See Debates Const. Conv. 1198). We are of the opinion, however, that a construction of this section would not be authorized which would permit commutations of State taxes in some other form than the one most prevalent when the constitution was adopted. The power to commute State taxes existed under the constitution of 1848, . . . but that instrument did not contain the express prohibition embodied in the constitution of 1870. This clause forbids commutations of State taxes in any form whatsoever, and it should not be shorn of its meaning and beneficial operation by judicial construction. *It was the substance, and not the mere form, of the evil which was intended to be guarded against.*"[149]

Particular significance is to be placed upon the court's reference to the substance of the evil to which Section 6 was directed. This is well borne out by the debate in the constitutional convention which followed a motion to strike out these provisions which became Section 6 of Article IX as finally adopted. The motion to strike this section was made by Mr. James C. Allen who observed that these provisions would preclude a proposal to finance the construction of a levee in his county by relieving the inhabitants of state property taxes for a period of several years. Mr. Thomas J. Turner responded by arguing for retention of the restriction upon release or commutation of State taxes:

> "I hope the section will not be stricken out. If there is a work to be executed in which the State has an interest, I desire that it be carried on by direct appropriation from the treasury, not by an indirect mode of remitting or releasing the State taxes. Why, sir, at the rate at which we have been going on lately, it will very soon come to pass that a few counties in the State will be compelled to bear almost the entire burdens of the State taxes.
>
> "I do wish, without entering into an argument upon this subject, to say that if a matter of sufficient importance should arise, the State can make an appropriation, and that if it is not of sufficient importance, the people in that section ought not to be relieved from the payment of their State taxes, and thus be permitted, indirectly, to appropriate what properly belongs to the State, to their private advantage."[150]

This statement forcefully enunciates the underlying philosophy of Section 6. It is clear that the constitutional convention had in mind the issue as to whether it is preferable as a matter of policy for the General Assembly to directly appropriate funds to finance local projects and activities of interest

[149] 196 Ill. 329, 340, 63 N.E. 745, 748 (1902). (Emphasis added).
[150] II Constl. Debates 1610 (1870).

to the state rather than subsidize such activities indirectly through the release or commutation of state taxes.[151]

Conclusion: A credit for local property taxes against a state tax based on income would not violate the uniformity requirements of Section 1, Article IX. It is likely, however, that such a credit would constitute a violation of Section 6, Article IX which prohibits the release or commutation of state taxes.

3. Exemption of Food Sales from Retailers' Occupation and Use Taxes. Among the important considerations involved in an expansion of the state tax base is the question as to whether the General Assembly could constitutionally remove the sale of food for consumption off the premises of the vendor from the application of the retailers' occupation and use taxes. The answer to this question turns on whether the decision in *Winter* v. *Barrett*[152] would operate as an insurmountable obstacle to such an exemption.

In the *Winter* case, the court held the first Retailers' Occupation Tax Act[153] unconstitutional, one of the principal reasons being that the act exempted from its application certain sales of farm produce and sales of motor fuel. By its terms, the act imposed a tax "upon persons engaged in the business of selling tangible personal property at retail." By definition, it was provided that " 'tangible personal property' does not mean or include farm products or farm produce sold by the producer thereof or motor fuel as defined in the Motor Fuel Tax Law." The statute was declared invalid on the ground that these exemptions violated the uniformity requirements of Section 1, Article IX. The court pointed out that one who was regularly engaged in the retail sale of farm produce, even though he was also regularly engaged in the business of producing farm products, was in fact engaged in a separate business of selling his produce in competition with non-producing retail dealers in such commodities. As to the producer of farm products, the court stated: "He is in the business of selling tangible personal property at retail in addition to the business of producing, and the exclusion of such business from the operation of the act, under such circumstances, finds no basis in fact upon which he may be reasonably placed in a different classification from the general class of taxpayers engaged in the selling of tangible personal property at retail created by the act."[154] With respect to the vendor of motor fuel, the court concluded: "The act, therefore, in exempting from the tax imposed, the business of selling motor fuel at retail, exempts without basis in fact, from the class created by the act, a business indubitably

---

[151] Although the burden of the local property tax may not be alleviated by a credit against a state tax, the state can accomplish the same objective by allocating additional state revenues to local governmental units to finance projects and activities which would otherwise be financed in whole or in part by local property taxes. This method of alleviating local property tax burdens is found in the allocation of state funds for relief, highways, and schools. To meet the requirements of Section 10, Article IX of the constitution, the allocation of state revenues must be for a project or activity which constitutes a *state* purpose as contrasted with a purely *local* or *corporate* purpose. Section 10 prohibits the imposition of a state tax for a strictly corporate purpose. People v. Jackson-Highland Bldg. Corp., 400 Ill. 533, 81 N.E. 2d 578 (1948).

[152] 352 Ill. 441, 186 N.E. 113 (1933).

[153] Ill. Laws 1933, at 938.

[154] 352 Ill. at 463, 186 N.E. at 123.

belonging thereto, and so violates the uniform requirements of the constitution."[155]

Thus the court by the language in its opinion in the *Winter* case adopted a rigid rule of uniformity. In effect, the court stated that the General Assembly, having selected the occupation of selling tangible personal property as the subject of taxation, could not exempt any occupation or transaction falling within the general classification without violating the uniformity requirements of Section 1, Article IX.

In only one case since *Winter* v. *Barrett* has the court been presented with the question as to whether the legislature may exempt certain retail sales from the application of the retailers' occupation tax. In 1953, the General Assembly amended the statute to exempt sales to the state and its political subdivisions and sales to organizations operated exclusively for charitable, religious and educational purposes. A similar exemption was incorporated in the use tax upon its adoption in 1955. By these provisions, sales to the state and its political subdivisions were specifically exempt from the tax, but sales to the federal government and sales to purchasers performing contracts for the federal government continued to be taxable. In *United States and Olin Mathieson Chemical Corporation* v. *Dep't of Revenue*,[156] the federal district court held that these provisions unreasonably discriminated against the federal government thus violating the principle of intergovernmental immunity. Following this decision, the General Assembly amended the retailers' occupation and use tax provisions to limit the exemption solely to sales to organizations operated exclusively for charitable, religious and educational purposes.

In the meantime, in *People ex rel Holland Coal Co.* v. *Isaacs*,[157] a suit was instituted in the state courts seeking a declaratory judgment that the exemption provision was invalid on the ground that it violated the uniformity requirements of Section 1, Article IX. The relator, relying upon *Winter* v. *Barrett,* contended that under the rule of that decision sales of tangible personal property at retail constituted a single class and that therefore all retail sales of tangible personal property must be taxed to comply with the uniformity requirements. The objector stressed the fact that the exemption of sales to charities discriminated in favor of those retailers who transact all or a part of their business with such institutions and against those retailers whose clientele does not include charitable institutions. The principal argument pressed upon the court was that the exemption provided in the statute turned solely upon the identity of the purchaser and bore no relationship whatsoever to the occupation of the vendor. Since the tax imposed by the act was upon the occupation of selling tangible personal property at retail, it was urged that the exemption was necessarily arbitrary and capricious. To state the argument differently, if there is a retail sale of tangible personal property, the transaction must be taxed to comply with the uniformity re-

[155] 352 Ill. at 466, 186 N.E. at 124.
[156] 191 F. Supp. 723 (N.D. Ill. 1961), *remanded*, 368 U.S. 30, 82 Sup. Ct. 146 (1961).
[157] 22 Ill. 2d 477, 176 N.E. 2d 889 (1961).

quirements irrespective of the identity of the purchaser. This, it was contended, was the clear import of the decision in *Winter* v. *Barrett* and there could be no classification whatsoever for purposes of the tax.

Although the argument presented in *Holland Coal Co.* was firmly supported by the opinion in *Winter* v. *Barrett*, the court, without referring to the *Winter* case, rejected the rigid rule of that decision and sustained the exemption of sales to charities as one based on a reasonable classification. With the decision in *Holland Coal Co.*, the court marks a complete departure from its previous position and affirmatively recognizes the propriety of classification for purposes of the retailers' occupation and use taxes. The issue is no longer one as to whether there may be an exemption, but one as to whether there is a reasonable basis for the particular exemption adopted. On this point, the decision in *Holland Coal Co.* leaves no ambiguity:

> "In stating the specific class upon which a tax is to be imposed, the legislature may define a general class and specifically remove a subclass (see *Bode* v. *Barrett*, 412 Ill. 204; *Modern Dairy Co.* v. *Department of Revenue*, 413 Ill. 55.) or it may merely define a subclass without naming the general class. (See *People* v. *Deep Rock Oil Corp.* 343 Ill. 388.) 'Persons engaged in the business of selling tangible personal property at retail' is a general class which the exemptive provision has in effect subclassified according to the nature of the purchaser. The legislative intent is clear that the retailers' occupation tax should apply to that specific class of person engaged in the business of selling tangible personal property at retail to other than the purchasers named in the exemptive provision. This specific class is the same whether it is defined as we have just done or by the use of an exemption as the legislature has done. The basic question is not the manner in which the class to be taxed has been defined, however, but whether there is any reasonable basis for the classification."[158]

From this platform, the court reiterated its commitment to broad legislative discretion and projected two tests for determining whether the classification was reasonable:

> "The legislature in levying an occupation tax has great latitude in establishing the class to which the tax shall apply. (*Reif* v. *Barrett*, 355 Ill. 104; *Ohio Oil Co.* v. *Wright*, 386 Ill. 206; *McGrath* v. *City of Chicago*, 309 Ill. 515.) The classifications in tax statutes must be based upon (1) real and substantial differences between persons taxed and those not taxed, (*Ohio Oil Co.* v. *Wright*, 386 Ill. 206; *City of Chicago* v. *Ames*, 365 Ill. 529,) and (2) they must bear some reasonable relationship to the object of the legislation, (*Modern Dairy Co.* v. *Department of Revenue*, 413 Ill. 55,) or to public policy. *Reif* v. *Barrett*, 355 Ill. 104."[159]

Having stated the two tests, the court proceeded in reverse chronological order to apply the second test first. The specific basis for the court's decision in sustaining the exemption of sales to charitable institutions was premised on considerations of economic burden and public policy. The court cited

[158] 22 Ill. 2d at 480, 176 N.E. 2d at 891.
[159] *Ib.*

the fact that charitable institutions assist the state in the performance of many functions which it would otherwise be obliged to fully assume. Since the burden of the retailers' occupation and use tax is borne by the purchaser, the operating costs of these institutions and thus their effectiveness is reduced by the amount of the tax. By relieving these institutions of this additional operating cost, their capacity to assist in the performance of those functions which ordinarily fall upon the state is thereby enhanced. The court stated its position as follows:

> "The obvious purpose of the legislature in enacting the exemption was to protect governmental units and charities from the burden of the tax that is shifted to them. Reduced costs of governments and reduced costs of charities, which relieve the state of many burdens it would otherwise be obliged to bear, will result when these purchasers can deal with retailers who are not subject to the tax. Although the classification is based in part on the identity of the purchaser, it takes into account the economic effect of the tax. We believe that such classification is not arbitrary or capricious but bears a reasonable relation to public policy."[160]

The first test, as to whether there was a substantial difference between the persons taxed and those not taxed under the exemption provision, was reserved for consideration in connection with the objection which was made as a consequence of the *Olin Mathieson* decision. The court recognized the effect of that decision and concluded that the provisions exempting sales to the state and its political subdivisions could not stand. In view of the taxability of sales to the state and federal governments, the ultimate question faced by the court was whether the exemption which was limited to sales to charitable institutions could stand under the uniformity requirements. Thus, the court was forced to find a sufficient difference between charities and governmental bodies to justify exemption of sales to the former and taxation of sales to the latter. This difference was found in the fact that charitable institutions do not possess the power to tax:

> "Governmental units and charities are generally exempted from taxation because such exemptions directly or indirectly tend to lower the cost of government. (See e.g., *Milward* v. *Paschen*, 16 Ill. 2d 302; *People ex rel. Brenza* v. *Turnverein Lincoln*, 8 Ill. 2d 198.) There are, however, real and substantial differences between them one of which is the power possessed by governmental units to enforce contribution from persons and property to support their purposes, (cf. *Kough* v. *Hoechler*, 413 Ill. 409; see also *31 I.L.P. Revenue* § 2,) a power which charities do not possess. We hold that governmental units and those with whom they deal can be placed in a class and be treated different from charities and those with whom they deal."[161]

With this conclusion, the exemption was validated on both counts—it was found to be based on a real and substantial difference between persons taxed

[160] 22 Ill. 2d at 481, 176 N.E. 2d at 891.

[161] 22 Ill. 2d at 483, 176 N.E. 2d at 892. The federal courts have also recognized this distinction between charities and governmental bodies. Subsequent to the *Holland Coal Co.* decision, the United States Supreme Court sustained the application of the retailers' occupation tax to sales to the federal government against the contention that the exemption of charities resulted in unconstitutional discrimination against the federal government. United States v. Dep't. of Revenue, 202 F. Supp. 757 (N.D. Ill. 1962), *aff'd mem.*, 371 U.S. 21, 83 Sup. Ct. 117 (1962).

and those not taxed; and it was held to bear a reasonable relationship not only to the object of the legislation, but also to public policy. The effect of the *Holland* case was to permit not merely classification, but subclassification under the retailers' occupation and use taxes.

The classification sustained in *Holland Coal Co.* was premised primarily upon the relation of the economic burden of the tax to considerations of public policy. To restate the court's decision: An exemption which encourages private institutions of charity to provide services which reduce the cost to the state of performing its functions, is a valid basis for separately classifying certain sales otherwise subject to tax. It is submitted that a similar argument can be made to support an exemption of food sales. Inasmuch as food purchases are an essential item in the household budget of all consumers, a greater economic burden with respect to the retailers' occupation and use taxes falls upon the lower income group which allocates a greater proportion of its spendable income to the purchase of food. This group, however, imposes the greatest burden upon the state with respect to public aid costs. A substantial portion of public aid expenditures are for food purchases and at the present rate of tax, these costs are increased by 4% as a consequence of the retailers' occupation and use taxes. Thus the state pays out this additional 4% in public aid only to collect it again in the form of the retailers' occupation and use taxes—an unnecessary and costly procedure. An additional point is that the burden of the tax on food tends to jeopardize those who live on a marginal subsistence income. Application of the tax to food purchases makes it more difficult for these citizens to be self-supporting and increases the risk that they will become public charges dependent upon public aid. For these reasons, a consideration of the economic burden of the tax on food sales warrants the conclusion that the exemption of these sales bears a reasonable relationship to public policy.

Although considerations of public policy provide a parallel basis for the exemption of food sales, the *Holland Coal Co.* decision states a much broader ground for sustaining such an exemption. At the outset the court observed:

> "In stating the specific class upon which a tax is to be imposed, the legislature may define a general class and specifically remove a subclass . . . or it may merely define a subclass without naming the general class . . . . The basic question is not the manner in which the class to be taxed has been defined . . . but whether there is any reasonable basis for the classification."[162]

If the General Assembly were to exempt sales of food, the statute, in effect, would provide for taxing "persons engaged in the business of selling tangible personal property at retail" except those selling food for consumption off the vendor's premises. To paraphrase the court's observation in *Holland Coal Co.* and apply it to the exemption of food sales, the legislative intent would be clear that the retailers' occupation tax should apply to that specific

[162] 22 Ill 2d at 480, 176 N.E. 2d at 891.

class of persons engaged in the business of selling tangible personal property except those engaged in the business of selling food for consumption off the premises. The questions to be resolved as indicated in *Holland Coal Co.* would be (1) whether such an exemption is "based upon real and substantial differences between persons taxed and those not taxed," and (2) whether the exemptions would "bear some reasonable relationship to the object of the legislation, *or* to public policy."

That there is a real and substantial difference between the business of selling foodstuffs or groceries and the business of selling other items of tangible personal property requires no argument or discussion. The business of selling foodstuffs is obviously different, for example, than the business of selling hardware, paint, clothing, automobiles, jewelry or any other item of personal property which is not consumed as food. The fundamental question is whether the legislature could separately select for taxation each and every class of merchant dealing in tangible personal property except those merchants dealing in groceries. On this point Article IX, Section 1 leaves little room for doubt inasmuch as "grocery-keepers" are specifically identified as a seperate class for the purpose of occupation taxes. If grocery-keepers could be selected as a separate class for imposition of an occupation tax, a fortiori they could be selected as a separate class for exemption from an occupation tax.

Additional support for recognition of grocers or vendors of food as a separate class within the general class of vendors of tangible personal property is to be found in *Peoples Gas Co.* v. *City of Chicago* [163] which sustained the separate classification of utility companies for the purpose of municipal taxation of gross receipts. In that decision, the court recognized broad legislative discretion to classify for purposes of occupation and privilege taxes and observed:

> "[T]here are cases where this court has upheld legislative classifications that differentiated between objects having similar characteristics or attributes. (*Johnson* v. *Halpin,* 413 Ill. 257, cigarettes, as distinguished from other tobacco products; *People* v. *Deep Rock Oil Corp.,* 343 Ill. 388, gasoline as distinguished from other kinds of motor fuel; *Routt* v. *Barrett,* 396 Ill. 322, horse racing, as distinguished from harness racing; *Reif* v. *Barrett,* 355 Ill. 104, sale of tangible personal property generally, as distinguished from sales under conditional sales contracts or sales on time or credit. See also *Heisler* v. *Thomas Colliery Co.,* 260 U.S. 245, bituminous coal, as distinguished from anthracite coal, and *Southwestern Oil Co.* v. *Texas,* 217 U.S. 114, wholesale dealers in coal, oil, naptha, benzine, or any other mineral oils refined from petroleum, as distinguished from other wholesalers.) Indeed, classifications have been approved where a general occupation has itself been subdivided in some reasonable manner. *McGrath* v. *City of Chicago,* 309 Ill. 515, tax on furniture movers graduated according to size and number of vehicles

[163] 9 Ill. 2d 348, 137 N.E. 2d 330 (1956). See the prior discussion of this case at p. 356 *supra.*

operated; *Metropolis Theatre Co.* v. *City of Chicago,* 246 Ill. 20, graduated license fees for theaters based on price of admission."[164]

Proceeding on the assumption that there is a real and substantial difference to warrant the separate classification of the sale of food, the second question is whether the exemption would "bear some reasonable relationship to the object of the legislation, *or* to public policy." The public policy relationship has been discussed previously at some length. Since the object of the legislation would be to remove the tax as a burden upon food, there can be no question that such objective would be accomplished.

It is well to note that with respect to the proposed exemption of food sales, a distinction can readily be made on the facts present in *Winter* v. *Barrett.* The exemption of food sales which was in question in the *Winter* case related only to retail sales of farm products by the producer; the exemption did not extend to all retail sales of food for consumption off the vendor's premises. This is a significant distinction, for a much stronger case can be made with respect to the reasonableness of a classification which exempts all food sales as contrasted with the narrow exemption provided in the statute under consideration in *Winter.*

Conclusion: In view of the recent decision in *People ex rel Holland Coal Co.* v. *Isaacs,* an exemption from the retailers' occupation and use taxes of the sale of food for consumption off the premises would probably be valid under Section 1, Article IX of the Illinois Constitution.

4. **General Exemptions and Deductions.** In the enactment of occupation, franchise and privilege taxes measured by gross or net income, the validity of exemptions and deductions would turn on the reasonableness of the resulting classification. A particular occupation tax, for example, might provide an exemption of the first $500 or the first $1,000 of gross or net income. Although this would result in some degree of progression in the case of a tax measured by gross income, this type of exemption would appear to fall within the permissible area of classification. There would be a reasonable relationship either to administrative convenience or to minimum subsistence to warrant the classification, and the exemption would be available to all taxpayers subject to the particular tax. Since an allowance of deductions for business expenses or expenses of producing income would generally operate uniformly and without discrimination, there would appear to be no serious question as to validity. The question of reasonable classification as to any exemptions or deductions provided in an occupation, franchise, or privilege tax would be governed by the decisions previously discussed in relation to the problem of graduated rates. There is no point in plowing the same ground, but particular attention is directed to the decision in *McGrath* v. *City of Chicago.*[165]

Conclusion: Uniform exemptions, and deductions for business expenses

[164] 9 Ill. at 355-56, 137 N.E. 2d at 334.
[165] See text discuussion at p. 385 *supra.*

and expenses of producing income allowed under occupation or privilege taxes measured by income would be consistent with the requirements of Section 1, Article IX of the Illinois Constitution.

E. Capital Stock Tax

1. Extension to Foreign Corporations. Consideration of the Illinois capital stock tax,[166] which by express statutory provision falls only upon domestic corporations,[167] presents a question as to whether the tax could be effectively extended to foreign corporations to equalize the tax burden upon the two classes of corporations.[168] It is common knowledge that many new corporations are organized under the laws of other states for the sole purpose of avoiding the assessment upon capital stock.[169] Extension of the capital stock tax to foreign corporations would, of course, tend to discourage out-of-state incorporation.

The present inequity as between domestic and foreign corporations rests upon the assessment of the Illinois corporation under the capital stock tax not only upon its intangible personal property, but also upon its goodwill or "going concern" value. The foreign corporation, on the other hand, is not subject to the capital stock assessment. Thus, it escapes an assessment upon its goodwill and is subject to tax only upon intangible personal property "located in this state and used in their business transacted in this state."[170] The difficulties in administering this latter provision for the taxation of intangibles of a foreign corporation are no less than those encountered in the assessment of individuals upon their intangible property.

The capital stock tax is a misnomer in that it is not a tax upon the privilege of operating in the corporate form measured by capital stock, but a property tax upon the intangible property of the corporation including going concern value or goodwill—the so-called "corporate excess."[171] Through the assessment of the capital stock, the entire value of goodwill of a domestic corporation is attributed to Illinois for property tax purposes. If the capital stock tax were extended to foreign corporations, the principal problem would be one of properly allocating the items of intangible property and goodwill to this state. If the corporation were operated solely within Illinois, there would be no difficulty. In that case, specific items of intangible property such as accounts receivable and bank accounts would have an exclusive "business" or "commercial" situs in Illinois. Similarly, the entire goodwill of the corporation would be allocable to this state. The difficult problem relates to the application of the tax to the foreign corporation which is engaged in the operation of an interstate business.

---

[166] Ill. Rev. Stat. ch. 120, §§ 498, 499, and 502 (1961).

[167] Western Union Tel. Co. v. Lieb, 76 Ill. 172 (1875) (holding that the statute by its terms was inapplicable to foreign corporations).

[168] Those who have made a critical study of the capital stock tax are generally unanimous in the conclusion that the tax is essentially unworkable and inequitable and should be abolished. Winakor, *General Corporation Taxes in Illinois*, REPORT OF THE REVENUE LAWS COMMISSION 156-200 (1949); Birdwell, *General Corporation Taxes*, pp. 602-45 *infra*.

[169] Birdwell, *General Corporation Taxes*, p. 630 *infra*.

[170] Ill. Rev. Stat. ch. 120, § 538 (1961).

[171] Central Ill. Service Co. v. Swartz, 284 Ill. 108, 119 N.E. 990 (1918).

The simplest method of taxing the intangible property including the goodwill of an interstate business would be to allocate these items on a formula basis. From the standpoint of due process, however, there would be serious doubt as to the propriety of taxing bank accounts and other intangibles such as accounts and notes receivable in this manner.[172] These items frequently acquire a specific "business" or "commercial" situs in another state and are subject to property taxes therein even though the corporation is a foreign corporation in the taxing state.[173] Thus, bank accounts, and notes and accounts receivable may be subject to ad valorem property taxes by both the state of legal domicile and the state of commercial domicile.[174] The decisions thus far, however, have not extended this doctrine of multiple taxation to permit ad valorem taxation by a third state on the theory that bank accounts and receivables have a general "commercial" or "business" situs allocable by formula to every jurisdiction in which the corporation may operate. An extension of the doctrine of "commercial" situs in this manner would be palpably unreasonable. The same objection would not apply, however, to the allocation of goodwill inasmuch as the goodwill of an interstate enterprise could reasonably be considered proportionately related to all of the activities of the business wherever conducted.

The due process problem in the application of the capital stock tax to foreign corporations is inherent in the nature of the tax as an ad valorem tax upon the intangible property of the corporation. If the tax were a *franchise* tax rather than a *property* tax, there would be no difficulty in applying the "unit rule" of valuation and allocating to the state all intangibles including bank accounts and accounts receivable as a measure of the tax.[175] Since the capital stock tax is a property tax, however, extension to foreign corporations would not alleviate the jurisdictional problems inherent in applying the present statutory requirement relating to the taxation of intangibles of foreign corporations engaged in interstate business.

Conclusion: Extension of the capital stock tax to foreign corporations engaged in interstate operations would not eliminate the difficult due process problems of jurisdiction to tax intangibles such as bank accounts and receivables.

---

[172] The Department of Revenue recognizes this problem by excluding "intangible personal property which has acquired [a] *business situs* outside the state" from the capital stock tax assessment of Illinois corporations. DEP'T. OF REVENUE, ILLINOIS ASSESSOR'S MANUAL 158 (1955).

[173] Wheeling Steel Corp. v. Fox, 298 U.S. 193, 56 Sup. Ct. 773 (1936) (Out-of-state bank accounts, and receivables of a Delaware corporation held subject to property tax by West Virginia, state in which the home office was located).

[174] *E.g.*, Commonwealth v. Universal Trades, Inc., 392 Pa. 323, 141 A. 2d 204 (1958), *appeal dismissed*, 358 U.S. 129, 79 Sup. Ct. 231 (1958) (Pennsylvania, state of incorporation, permitted to tax out-of-state bank accounts and receivables which were also subject to taxation in Florida by reason of commercial or business situs).

[175] This distinction has recently been emphasized in a New Jersey case which sustained the allocation of headquarter assets including bank accounts and receivables located in Chicago for purposes of an annual excise tax measured by net worth. Household Finance Corp. v. Director, Div. of Taxation, 36 N.J. 353, 177 A. 2d 738 (1962), *appeal dismissed* 371 U.S. 13, 83 Sup. Ct. 41 (1962). It is of interest to note that the Illinois Supreme Court, in the absence of statutory authorization, struck down on attempt by the Cook County assessor to assess the intangible personal property of a foreign corporation by formula allocation. The case was decided solely on the basis of lack of statutory authority and the court did not reach the due process question. Wheelock, Lovejoy & Co. v. Gill, 366 Ill. 378, 9 N.E. 2d 58 (1937).

F. Inheritance Tax

1. Life Insurance Proceeds—Treatment under present statutory provisions. Although the Illinois Inheritance Tax contains no provisions specifically relating to life insurance contracts, this statutory deficiency has been met by long-standing provisions in the regulations. Pursuant to the regulations, life insurance proceeds payable to the estate of the insured are included in the gross estate in determining inheritance tax liability.[176] There is no question as to the propriety of this rule even though the insured may have held no incidents of ownership in the policy during his lifetime and may have paid none of the premiums on the policy. The statute taxes all transfers "by will or by the intestate laws of this State."[177] Proceeds of insurance payable to the estate of the insured fall within the statutory language as amounts transferred pursuant to the provisions of the decedent's will or in accordance with the statute governing intestate distribution.

By contrast, insurance proceeds payable to third party beneficiaries have been excluded from the gross estate even though the decedent may have held all incidents of ownership prior to death and may have paid all the premiums upon the policy.[178] This exclusion is apparently premised on the conclusion that there is no "transfer" which falls within the scope of the statutory language. There is, of course, no transfer by will or by the intestate laws. The question then is whether the designation of a beneficiary constitutes a transfer "by deed, grant, bargain, sale or gift" (1) "made in contemplation of death," (2) "intended to take effect in possession or enjoyment at death," or (3) with respect to which the insured has retained a power of revocation.[179]

Although there is contrary authority,[180] the prevailing view on this point is that the interest of the beneficiary arises solely by the terms of the insurance contract and takes effect immediately upon the designation thereof. On this ground, it has been held that there is no inter vivos transfer of the proceeds "by deed, grant, or gift" within the intendment of comparable statutory provisions. The rationale for this rule is best stated in the leading case of *Tyler* v. *Treasurer and Receiver General*:

> "The insured retains no ownership of that which has passed to the beneficiary under the contract. A reserved right to change the beneficiary does not affect the essential nature of the rights of the beneficiary so long as they last. Whatever the insured does in way of designation of a beneficiary takes effect forthwith. If his act rightly be describable as a gift, it is a present gift which, so far as concerns him, takes effect at once both in possession and enjoyment by the beneficiary. . . . There is no fund in which he has an ownership which is the subject of his act in designating the beneficiary. . . . *The insured has no title to the amount due on the policy. He does not and cannot make a gift of that. The*

---

[176] ATT'Y. GEN., ILL. INH. TAX MANUAL 16 (1961).
[177] Ill. Rev. Stat. ch. 120, § 375(1) (1961).
[178] This exclusion is not affirmatively stated in the regulations but it is implied in that the regulations merely provide that the taxable estate shall include proceeds of insurance payable to the estate or to the personal representative. ATT'Y. GEN., ILL. INH. TAX MANUAL 16 (1961).
[179] Ill. Rev. Stat. ch. 120, § 375(3) (1961).
[180] Fagan v. Bugbee, 105 N.J.L. 85, 143 Atl. 807 (1928).

> *right to that amount as an instant obligation does not spring into existence until after his death.* Even then the money belongs to the insurer, who is charged with the duty by the contract to pay to the beneficiary. So far as the insured is a 'grantor,' to use the word of the statute, the only thing which he grants or can grant is an interest in a contract. So far as he can make a 'gift,' the only thing which he has to give is a right in a contract. By designating a beneficiary both the 'grant' and the 'gift,' so far as either exist at all, take effect in enjoyment and possession at once. Such a relation does not by fair intendment come within the descriptive words of the statute as 'property * * * which shall pass * * * by * * * gift * * * made or intended to take effect in possession or enjoyment after the death of the grantor.' "[181]

There is no question as to the accuracy of the observation in the *Tyler* decision that the insured has no title to the amount paid under the contract and thus could not transfer this sum to the beneficiary. However, in applying the provisions relating to transfers intended to take effect at death, this general statement overlooks the situation where the insured retains until his death, the right to the cash surrender value of the policy. In this case, it can be said that the position of the insured with respect to the cash surrender value is not unlike that of one who has made a deposit of a certain sum in a bank which could be withdrawn at any time during his lifetime, and if not withdrawn was to be paid over to another upon his death.[182] Thus, to the extent of the cash surrender value of a policy owned by the insured at the date of his death, there is a transfer which takes effect at death.

This result as to cash surrender value is clearly supported by the decision in *People* v. *Schallerer*[183] where it was held that the unpaid balance of a refund annuity contract payable to a named beneficiary was subject to the inheritance tax as a transfer intended to take effect in possession or enjoyment at death. In reaching this result, emphasis was placed upon the incidents of ownership in the contract, namely, the decedent's right during his lifetime to the cash surrender value, and his power to revoke or change the designation of beneficiaries.[184] The same incidents of ownership would sustain an inheritance tax upon that portion of the insurance proceeds payable to third party beneficiaries equal to the cash surrender value immediately prior to the death of the insured.

An extension of the rationale of the *Schallerer* case would result in taxing a portion of life insurance proceeds payable to third party beneficiaries, but it would leave untaxed the balance of the proceeds in excess of the cash surrender value. This excess, which represents the insurance risk, is not the subject of an inter vivos transfer to take effect at death.[185] To reach the entire proceeds of life insurance payable to third party beneficiaries, it would be

[181] 226 Mass. 306, 309, 115 N.E. 300, 301 (1917). (Emphasis added).
[182] See Gregg v. Comm'r of Corp. & Taxation, 315 Mass. 704, 707, 54 N.E. 2d 169, 171 (1944) (discussing decedent's rights under a refund annuity contract including cash surrender value).
[183] 12 Ill. 2d 240, 145 N.E. 2d 585 (1957).
[184] 12 Ill. 2d at 243, 145 N.E. 2d at 586-87.
[185] In the *Schallerer* decision the court observed that the amount taxed represented investment values available to the decedent during his lifetime and not amounts acquired by the beneficiaries "by virtue of the occurrence of a stated risk." 12 Ill. 2d at 343, 145 N.E. 2d at 587.

necessary, as a number of states have done, to specifically provide for such result by statutory amendment.

Constitutional problems in taxing proceeds payable to third party beneficiaries. The constitutional questions relating to an extension of the inheritance tax to life insurance proceeds payable to third party beneficiaries turn upon the legislative formula which might be adopted. On the basis of federal and state experience, the formula might consist of either one or both of two tests, namely, the ownership test and the premium payment test.

During the period from 1942 to 1954, the federal estate tax provision included both tests in the alternative.[186] If the decedent possessed at death any of the incidents of ownership, the entire proceeds were included in the taxable gross estate irrespective of whether the decedent had paid any of the premiums on the policy. On the other hand, if the insured held none of the incidents of ownership at death but he had paid, directly or indirectly, all or part of the premiums, his taxable gross estate included the proceeds in the ratio of the aggregate premium payments by the decedent to the total premium payments made under the contract.

The ownership test as a criterion for taxing life insurance proceeds payable to third party beneficiaries was challenged under earlier provisions of the federal estate tax which included in the gross estate proceeds in excess of $40,000 received under "policies taken out by the decedent upon his own life." It was contended that there was no transfer at death since the interest of the beneficiary under the contract was fully vested. On this ground it was urged that the tax did not constitute an excise upon the privilege of transfer at death, but a direct tax on property which was unconstitutional for failure to apportion. In *Chase National Bank* v. *United States*,[187] the Supreme Court responded as follows:

> "It is true, as emphasized by plaintiff, that the interest of the beneficiaries in the insurance policies effected by decedent 'vested' in them before his death and that the proceeds of the policies came to the beneficiaries not directly from the decedent, but from the insurer. But until the moment of death the decedent retained a legal interest in the policies which gave him the power of disposition of them and their proceeds as completely as if he were himself the beneficiary of them. The precise question presented is whether the termination at death of that power and the consequent passing to the designated beneficiaries of all rights under the policies freed of the possibility of its exercise may be the legitimate subject of a transfer tax, as is true of the termination by death of any of the other legal incidents of property through which its use or economic enjoyment may be controlled.
>
> "A power in the decedent to surrender and cancel the policies, to pledge them as security for loans and the power to dispose of them and their proceeds for his own benefit during his life . . . is by no means the least substantial of the legal incidents of ownership, and its termination at his death so as to free the beneficiaries of the policy from the possi-

[186] Int. Rev. Code of 1939, § 811(g), as amended.
[187] 278 U.S. 327, 49 Sup. Ct. 126 (1929).

bility of its exercise would seem to be no less a transfer within the reach of the taxing power than a transfer effected in other ways through death."[188]

As an alternative contention, it was asserted that even though there may have been a transfer at death, the transfer was not from the decedent to the beneficiary but from the insurer and that the estate tax, as an excise, applied only to transfers by the decedent. This argument was found equally unpersuasive:

"Obviously the word 'transfer' in the statute, or the privilege which may constitutionally be taxed, cannot be taken in such a restricted sense as to refer only to the passing of particular items of property directly from the decedent to the transferee. *It must, we think, at least include the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another.*"[189]

It is significant, as indicated by the preceding excerpts, that the court in *Chase National Bank* emphasized not only the incidents of ownership held by the insured until death, but also the fact that the insured had paid the premiums upon the policy. Through the years prior to 1942, the Treasury Department vacillated between the ownership test and the premium payment test. The dual test was finally incorporated in the Internal Revenue Code of 1939 by the Revenue Act of 1942.[190] The dual test was retained until 1954 when the premium payment test was dropped and the ownership test retained as the exclusive basis for taxing insurance proceeds payable to third party beneficiaries.[191]

State court decisions dealing with the question of taxing life insurance proceeds payable to third party beneficiaries have consistently recognized the validity of basing the tax upon incidents of ownership. In fact, where the statutes have provided in general terms for taxing proceeds payable to third party beneficiaries without spelling out the criterion upon which the tax is based, the courts have either construed the provisions as requiring incidents of ownership in the insured or have stressed the fact that the insured in the particular case held incidents of ownership in the policy.[192]

In Re Allis's Will,[193] one of the earliest cases to sustain an inheritance tax with respect to life insurance payable to third party beneficiaries, was decided under a Wisconsin statute enacted in 1915 which provided in broad terms that "insurance payable upon the death of any person shall be deemed a part of his estate for the purpose of the tax and shall be taxable to the person

---

188 278 U.S. at 334-35, 49 Sup. Ct. at 127-28.
189 278 U.S. at 337, 49 Sup. Ct. at 128.
190 Revenue Act of 1942, § 404, Ch. 619, 56 Stat. 944 (1942).
191 Int. Rev. Code of 1954, § 2042.
192 *E.g.*, (1) Proceeds held taxable where the insured held incidents of ownership at death: Dumesnil v. Reeves, 283 Ky. 563, 142 S.W. 2d 132 (1940); In Re McGrath's Estate, 191 Wash. 496, 71 P. 2d 395, *cert. denied*, 303 U.S. 651, 58 Sup. Ct. 749 (1937); In Re Allis' Will, 174 Wis. 527, 184 N.W. 381 (1921). (2) Proceeds held nontaxable where the insured held no incidents of ownership at death: Rogers v Oklahoma Tax Comm'n, 263 P. 2d 409 (1952). (3) Proceeds held nontaxable where the insured held no incidents of ownership and paid no premiums on the policy: Martin v. Storrs, 277 Ky. 199, 126 S.W. 2d 445 (1939); Blue Diamond Poultry Farm, Inc. v. Comm'r, 253 Minn. 265, 91 N.W. 2d 598 (1958); Werthan v. McCabe, 164 Tenn. 611, 51 S.W. 2d 840 (1932); In Re McGrath's Estate, *supra*.
193 174 Wis. 527, 184 N.W. 381 (1921).

or persons entitled thereto." In the *Allis* case the insured husband, prior to the enactment of the statute, had taken out life insurance contracts upon his own life payable to his wife. The insured held all incidents of ownership and paid all the premiums thereon. After emphasizing the fact that the insured had retained a property interest in the contracts which did not become absolutely vested in the beneficiary until his death, the court concluded:

> "The nature and quality of such beneficial interest in these policies during the insured's life constitute a good ground for legislative action to subject the proceeds realized therefrom to inheritance taxation upon the basis that they 'shall be deemed a part of his estate for the purposes of the tax and shall be taxable to the person or persons entitled thereto.' It is not essential that such proceeds shall become a part of the deceased husband's estate upon his death in order to subject them to inheritance taxation. It is self-evident that by means of these policies the husband transferred a large part of his estate to his widow, which became effective at his death. This puts the transaction within the field of inheritance taxation."[194]

Alternatively, the court took the position that the tax was valid even if the widow's property interest in the contracts were deemed fully vested prior to the death of the insured:

> "[I]t is manifest that this insurance fund in the hands of the widow is within the field of inheritance taxation even if it were considered that the husband's interests had been transferred to his widow before his death under the terms of the insurance contract. Such a transaction would in substance be a transfer of his property to her and constitutes in legal effect a transfer of the same kind as is accomplished by a gift. It must be borne in mind that the statute provides:
>
> 'Insurance payable upon the death of any person shall be deemed a part of his estate for the purposes of the tax.'
>
> "Here we have a plain declaration that such a transfer which was intended to take effect in possession or enjoyment when the husband died shall be subjected to the tax upon the ground that the widow in fact came into possession and enjoyment of this property from him at his death."[195]

Thus the Wisconsin court in this early decision subscribed to both the ownership test and the premium test as valid bases for imposition of an inheritance tax upon life insurance proceeds payable to a third party beneficiary.

Typical of the established view that incidents of ownership may be a proper basis upon which to tax insurance proceeds under an inheritance tax is the following statement in a Minnesota decision, *De Coster* v. *Comm'r of Taxation*: "It is generally conceded that under life insurance policies in which the insured has the right of changing the beneficiary and the right to receive its surrender value the proceeds received by the beneficiary upon the death of the insured may be subjected to an inheritance tax."[196]

In the *De Coster* decision the court dealt with an amendment to the

[194] 174 Wis. at 534, 184 N.W. at 383.
[195] 174 Wis. at 534-35, 184 N.W. at 384.
[196] 216 Minn. 1, 5, 11 N.W. 2d 489, 491 (1943).

Minnesota inheritance tax which provided that the tax should apply to "the proceeds of all such policies now in force payable to named beneficiaries in which the insured has the right to change the beneficiary or under which he has cash surrender right." As of the effective date of the act, the insured held all the incidents of ownership in the policy. About one year prior to his death, he assigned the policy by gift absolutely to his wife so that he held no incidents of ownership at the date of his death: however, he paid all the premiums upon the contract. The court observed that the statute, by its terms, was clearly applicable in the particular circumstances and held the statute valid. Under this decision, the ownership test may be applied with respect to any insurance contract which may have been owned by the insured at any time during the period beginning with the effective date of the taxing act and ending with the date of death. Thus, either the inter vivos gift of the policy, or the extinguishment of the insured's interest therein by death may be deemed a taxable transfer under an inheritance tax statute.

Generally, the states which have adopted the ownership test apply the test as of the date of death so that the insured must hold incidents of ownership at death.[197] The fact that the contract may have been acquired prior to enactment of the statute is no bar to application of the provisions inasmuch as the beneficiary acquires no vested interest in the contract until the death of the insured.[198] Under these statutes, however, an inter vivos transfer would remove the insurance proceeds from the taxable estate unless the transfer were made in contemplation of death.

The premium payment test as a basis for taxing the proceeds of life insurance in the estate of the insured has not been generally adopted by the states under their respective death tax statutes.[199] Consequently, there have been no state court decisions directly ruling upon the constitutionality of this test. There is dictum in the *Allis* case, as indicated in the foregoing discussion, which endorses the premium payment test as a proper basis for an inheritance tax. The emphasis in that opinion is upon the fact that the event which produced the economic benefits received by the beneficiary under the contract was the death of the insured who had paid all the premiums on the contract. In a subsequent Washington decision, *In Re McGrath's Estate*,[200] the court held unconstitutional a statute which would have taxed the proceeds of insurance where the decedent held no incidents of ownership and had paid none of the premiums. The opinion in the *McGrath* case suggests that inasmuch as a death tax is upon a "transfer" of property at death, the

[197] Rogers v. Oklahoma Tax Comm'n, 263 P. 2d 409 (1952). Proceeds of life insurance payable to third party beneficiaries was subject to tax if "at the time of death, the decedent had the right, directly or indirectly, to change the beneficiary or to convert the policy to his own use." Statute held inapplicable to the proceeds of policies in which ownership had been fully vested in the wife from date of issuance.

[198] *E.g.*, Dumesnil v. Reeves, 283 Ky. 563, 142 S.W. 2d 132 (1940).

[199] Arizona and North Carolina are apparently the only states presently applying the premium payment test with respect to insurance proceeds payable to third party beneficiaries. It should be added, however, that where a state death tax was based upon the credit allowed under the federal estate tax during the period 1942 to 1954, the premium test, in effect, was made applicable under the state tax.

[200] 191 Wash. 496, 71 P. 2d 395 (1937), *cert. denied*, 303 U.S. 651, 58 Sup. Ct. 749 (1937).

insured must possess incidents of ownership in the contract at the time of his death: "It is therefore, in the very nature of things, impossible for an estate or inheritance tax to be exacted with respect to something in which the decedent did not own or have some kind of right at the time of his death, for in such a case there is no transfer."[201] This statement constitutes an overgeneralization. If strictly accurate, there would be a bar to imposition of an inheritance tax upon absolute inter vivos gifts consummated in contemplation of death.

In a later case, *Wachovia Bank & Trust Co. v. Maxwell,*[202] the North Carolina court held as a matter of statutory construction that the statute was not applicable to insurance proceeds where the husband had paid all the premiums upon a policy, the property rights having been fully vested in the wife from the inception of the contract. The North Carolina statute was subsequently amended in 1943 to incorporate the premium payment test and the constitutionality of these provisions apparently has never been challenged.[203]

Any serious doubt as to the propriety of utilizing the premium payment test as a basis for imposing an inheritance or estate tax has been removed, however, by a recent decision sustaining the premium test which was in effect under the federal estate tax from 1942 to 1954. In *United States* v. *Mfrs. Nat'l Bank,*[204] the decedent, who died in 1954 prior to enactment of the Internal Revenue Code of 1954, had made an absolute assignment of an insurance contract to his wife in 1936. He continued until his death to pay all the premiums on the policy. Inclusion of the proceeds in the decedent's estate pursuant to the formula provided in the statute was challenged on the ground that since the decedent held no incidents of ownership in the policy at death there was no "transfer" to which the estate tax could apply. It was argued, therefore, that the result was to impose a tax upon the property of the beneficiary without apportionment as required by the Constitution. In disposing of this contention, the Court emphasized the fact that the estate tax is premised upon taxable "events" selected by the Congress as distinguished from particular property interests involved: "If there is any taxable event here which can fairly be said to be a 'transfer' under this language . . . [of the Code], the tax is clearly constitutional without apportionment."[205] The Court concluded that the Congress could properly select the maturing of the contract at the death of the insured as a taxable event:

> "Under the statute, the occasion for the tax is the maturing of the beneficiaries' right to the proceeds upon the death of the insured. Of course, if the insured possessed no policy rights, there is no transfer of any interest *from him* at the moment of death. But that fact is not material, for the taxable 'transfer,' the maturing of the beneficiaries' right to the

201 191 Wash. at 503, 71 P. 2d at 398.
202 221 N.C. 528, 20 S.E. 2d 840 (1942).
203 N.C. Sess. Laws 1943, ch. 400, § 1(c).
204 363 U.S. 194, 80 Sup. Ct. 1103 (1960).
205 363 U.S. at 198, 80 Sup. Ct. at 1106.

> proceeds, is the crucial last step in what Congress can reasonably treat as a testamentary disposition by the insured in favor of the beneficiaries. That disposition, which began with the payment of premiums by the insured, is completed by his death. His death creates a genuine enlargement of the beneficiaries' rights. It is the 'generating source' of the full value of the proceeds. . . . The maturing of the right to the proceeds is therefore an appropriate occasion for taxing the transaction to the estate of the insured."[206]

The analysis applied by the Court is precisely the same as that suggested in the *Allis* decision and is equally applicable whether the tax is an inheritance tax or an estate tax.

Conclusion: Extension of the inheritance tax to apply to life insurance proceeds payable to third party beneficiaries would be valid whether the tax were based upon incidents of ownership held by the decedent, or payment of premiums by the decedent, or both.

2. Survivor Benefits Under Retirement Programs. In considering the scope of the Illinois inheritance tax, a question has arisen as to the applicability of the statute to annuities and death benefits payable to beneficiaries of deceased employees under pension and profit-sharing plans. There is no specific statutory provision relating to these plans, but the regulations currently provide that the decedent's taxable estate shall include (1) as property owned by the decedent, the value of his vested interest in pension, retirement, and profit-sharing plans, and (2) as transfers intended to take effect at death, the proportionate share of death benefits represented by the decedent's contribution in company pension and retirement plans and his vested interest in profit-sharing plans.[207] Although the regulations are ambiguous, it is apparently the practice of the Attorney General not to tax certain survivorship benefits which are attributable to the employer's contributions.

The issue as to the applicability of the inheritance tax to survivor benefits is whether there is a transfer "of property . . . intended to take effect in possession or enjoyment at or after . . . death."[208] On this point there is an impressive accumulation of authority in the various states which have applied these provisions of their respective death tax statutes to tax survivor benefits whether the amounts were paid under contributory or noncontributory plans.

An Ohio case, *In Re Daniel's Estate,*[209] applied the provisions relating to transfers intended to take effect at death to a noncontributory plan. The provisions of the trust were as follows: (1) the employee was permitted to designate a beneficiary; (2) if the designated beneficiary were to predecease the employee, the benefits were payable to the employee's estate; (3) the employee's interest was subject to a spendthrift provision; and (4) the amount contributed by the employer on behalf of the employee was credited

[206] 363 U.S. at 198-99, 80 Sup. Ct. at 1106.
[207] ATT'Y. GEN., ILL. INH. TAX MANUAL 16 and 21.
[208] Ill. Rev. Stat. ch. 120, § 375(3) (1961).
[209] 159 Ohio St. 109, 111 N.E. 2d 252 (1953).

to the employee's separate account and was nonforfeitable. It was contended that the survivor benefits received by the wife under the trust were non-taxable on the ground that there was no transfer *from* the decedent to the beneficiary. The court recognized that the employee had a property interest under the trust and held that there was a transfer which took effect at death:

> "The trust fund belongs to the employees, each being the owner of his allotted portion, although the actual possession and control thereof is postponed pending severance or retirement of the employee, or, as in this instance, the death of the employee. No one but such employee has the right to make any disposition of the money thus belonging to him and the consummation of the gift thereof is merely postponed. In the meantime, each employee has a vested property right in the trust fund credited to his individual account. . . . Under the facts in this case, the deceased employee's share of the fund remained intact until his death. . . .
>
> "The fund definitely set aside for the employee . . . whether deemed additional compensation or otherwise, was his to dispose of at his death just as any other property which he possessed, and by his direction it passed to his designated beneficiary."[210]

The Michigan court, *In Re Brackett's Estate,*[211] relied upon the *Daniel* decision in reaching the same result in a case squarely on all fours. The court explained its approach to the problem of statutory interpretation as follows:

> "The statute requires, however, not only an interest in property, but a transfer of such interest. The difficult cases involving transfer are those in which the owner of the vested right does nothing, or merely cuts down his present interest in favor of enlarging (or creating) an interest in another. Even in such cases, under related laws, transfer has been found under various theories. . . . The reason lies not only in the breadth of the modern taxing statutes but in the consideration that the essence of a transfer has come to be identified more nearly with a change of economic benefits than with technicalities of title. We do not, in construing a taxing statute, require for transfer a formal common-law conveyance."[212]

In both the *Daniel* and *Brackett* cases it was argued without success that the payments were analogous to payments under a life insurance contract and should not be taxed.

In 1960, the Maine court reached the same conclusion and held the wife's benefits under a noncontributory plan to be taxable:

> "[I]n the instant case we think that the interest of the decedent in the trust fund, comprising what was in effect deferred compensation earned by him through loyal service, was not only more than a mere expectancy but was the 'equivalent of ownership' for 'purposes of taxation.' Thus the designation of the widow as beneficiary was more than the exercise of a limited power of appointment over the property of another—it was a 'grant' of an 'interest in property' within the meaning of . . . [the statute] intended to and in fact taking effect upon the death of the dece-

210 159 Ohio St. 113-14, 111 N.E. 2d at 254-55.
211 342 Mich. 195, 69 N.W. 2d 164 (1955).
212 342 Mich. at 206, 69 N.W. 2d at 169.

> dent. The designation served effectively to change the flow of economic benefits in which decedent had acquired an interest away from his estate and to the widow."[213]

Additional cases on this problem include decisions in Connecticut, New Jersey, New York, Pennsylvania, and Wisconsin, all holding survivor benefits under retirement plans to be taxable as transfers intended to take effect at death.[214]

Conclusion: The Illinois inheritance tax provisions relating to transfers intended to take effect at death are applicable to survivor benefits provided under employee retirement, pension, and profit-sharing plans whether the plans are contributory or noncontributory.

---

[213] Gould v. Johnson, 156 Me. 446, 453, 166 A. 2d 481, 484-85 (1960).

[214] Dolak v. Sullivan, 145 Conn. 497, 144 A. 2d 312 (1958); Cruthers v. Neeld, 14 N.J. 497, 103 A. 2d 153 (1954); In the Matter of Estate of Endemann, 307 N.Y. 100, 120 N.E. 2d 514 (1954); In Re Dorsey's Estate, 366 Pa. 557, 79 A. 2d 259 (1951); Estate of Stone, 10 Wis. 2d 467, 103 N.W. 2d 663 (1960).

PART II—REVISION OF THE REVENUE ARTICLE

A. Proposals for Revision

Proposals for revision of Article IX of the Constitution of 1870 have centered primarily upon the desirability of a classified property tax and the specific authorization of an income tax. The uniformity requirements of the present Article IX have precluded legislative classification of real and personal property[215] and have been construed to bar an income tax. There is, of course, well recognized de facto classification of property in Illinois which has no constitutional or legal basis. This consists of the failure to assess intangibles, the omission of automobiles and household furnishings from the tax rolls in some areas of the state, and the assessment of different classes of property at different ratios of fair market value.

To correct the general disregard for the requirements of the constitution and statutes in the administration of the property tax and to permit equitable adjustments in its application, there has been considerable support for a classified property tax and some suggestions that the tax on personal property be entirely abolished. There has been a lack of unanimity, however, with respect to the nature of a classified property tax. Some have advocated a general classified property tax covering both real and personal property; others support a classification limited to intangibles and selected items of tangible personal property such as motor vehicles and household furnishings. Proposals for specific authorization of an income tax have varied from a broad grant of authority to a restriction limiting such a tax to a flat rate subject to approval by referendum.

It was deemed worthwhile to appraise the various proposals in the light of the constitutional provisions of a representative number of states. To make this comparison, the following fourteen states have been selected, in part upon the basis of geographical distribution and in part upon the basis of industrial and economic development:

California	Missouri
Florida	New Jersey
Indiana	New York
Iowa	Ohio
Massachusetts	Pennsylvania
Michigan	Texas
Minnesota	Wisconsin

This comparative study is based on existing constitutional and statutory provisions. Michigan adopted a new constitution by approval of the electors in April, 1963 and the provisions of the new constitution are reflected in these materials.

---

[215] Cushman, *The Proposed Revision of Article IX of the Illinois Constitution,* 1952 U. Ill. Law Forum 226, 235.

B. Comparison of the Revenue Provisions of Fourteen Selected States

1. Property Taxes.

Real Property. The constitutional provisions of the fourteen states governing ad valorem taxation of real property are summarized as follows:

Classification Prohibited. Three states, California, Indiana, and Ohio, prohibit classification of real property in any manner.

Limited Classification. Seven states, Florida, Massachusetts, Michigan, Missouri, New Jersey, Texas and Wisconsin, authorize some form of limited classification. None of these seven may classify by assessing different classes of real property at different rates. Two, Massachusetts and Wisconsin, may classify by exemption. Three, Massachusetts, Missouri and Wisconsin, are granted specific authority to classify forest lands, and Wisconsin may also classify mineral lands. Two state constitutions specifically provide a homestead exemption, Florida ($5,000) and Texas ($3,000). Massachusetts has enacted a homestead exemption of $2,000. New Jersey specifically authorizes an exemption for veterans. Under the new Michigan constitution, designated real property may be selected for in lieu taxation, uniform as to the class.

General Classification. The constitutional provisions of four states, Iowa, Minnesota, New York, and Pennsylvania, permit general classification of real property uniform as to the class. Of this group, only Minnesota has adopted a comprehensive scheme of classification of real property. Iowa has enacted a homestead exemption of $2,500. New York has classified forest lands, adopted certain veterans' exemptions, and enacted special provisions applicable to selected railroad property.

Personal Property. It is significant that some degree of classification of personal property is permitted by all fourteen states selected for comparison. The extent of classification permitted varies from limited authorization to broad powers of classification.

Limited Classification. Six of the fourteen states, Florida, Indiana, Massachusetts, Michigan, Texas, and Wisconsin permit limited classification of personal property. Florida is specifically authorized to classify intangibles and to impose license fees on automobiles in lieu of ad valorem taxes.

Indiana is generally subject to the requirement of strict uniformity under its constitutional provisions but, by judicial construction, classification of intangibles under a "privilege" tax has been sustained.

Massachusetts cannot classify by assessing at different rates, but it can classify by exemption. Automobiles are exempt from ad valorem taxation.

Under its new constitution, Michigan can select designated items of tangible personal property for in lieu taxation. Ad valorem taxation of intangibles is not authorized.

Texas has no general authority to classify, but the constitution provides a nominal exemption of $250 each with respect to household furniture and farm produce.

Wisconsin cannot classify for assessment at different rates except with respect to inventories. It does have broad powers to classify by exemption and it exempts intangibles and automobiles from ad valorem taxation.

General Classification. Eight of the group of selected states grant broad powers of classification with respect to personal property. Two states, New York and Pennsylvania, do not tax tangible personal property. The New York constitution specifically prohibits a tax upon intangibles and the other states, California, Iowa, Minnesota, Missouri, New Jersey, Ohio, and Pennsylvania, either classify or exempt intangibles. In this group, with the exception of Missouri, automobiles are subject only to motor vehicle license taxes.

2. Excise Taxes.

General Powers. Of the selected group of fourteen states, ten are granted broad general powers to impose excise taxes which need only apply uniformly as to class. These states are:

California	New Jersey
Indiana	New York
Iowa	Ohio
Minnesota	Texas
Missouri	Wisconsin

The only specific restriction applicable to any state within this group is found in the Ohio constitution which prohibits a sales tax upon the sale of food for consumption off the premises of the vendor.

Restricted Powers. Four of the group of selected states, Florida, Massachusetts, Michigan, and Pennsylvania, are limited in the exercise of their powers to impose excise taxes. The Florida constitution prohibits a graduated income tax and limits the imposition of an inheritance tax to the credit allowed under the federal estate tax.

Massachusetts possesses fairly broad powers with respect to the imposition of excise taxes but there are decisions which appear to restrict the legislature in the selection of taxable privileges. Although there is a constitutional amendment authorizing an income tax and permitting the taxation of different classes of income at different rates, the court has construed these provisions to be subject to a strict proportional rule so that the various classes of income may be taxed only at flat rates.

The new Michigan constitution prohibits a graduated income tax and limits a retail sales tax to a maximum rate of 4%.

Pennsylvania holds a general power to impose excise taxes uniform as to class but is limited by judicial construction of its uniformity provisions to nongraduated excise taxes. Thus an income tax could be imposed only on a flat rate basis without exemption.

Income Taxes. Of the fourteen states, the ten enumerated above under the classification of broad general powers have authority either by specific

grant in the constitution or by judicial construction to impose graduated income taxes. Three of the ten, New Jersey, Ohio, and Texas, have not exercised their powers to impose a general income tax. Indiana adopted a flat-rate gross income tax in 1933 and has recently (April, 1963) added a flat-rate net income tax.

Six of the group, California, Iowa, Minnesota, Missouri, New York, and Wisconsin, impose general income taxes. In addition, Massachusetts imposes an income tax at varying flat rates upon different classes of income.

3. Exemptions.

Most of the states provide an exemption under the property tax for intangibles held by qualified pension trusts. Some states cannot constitutionally exempt real and tangible personal property owned by these trusts. As a policy matter, it is questionable whether real estate investments of pension trusts, religious, charitable, or educational organizations should be exempt from ad valorem taxation. The income of pension trusts, however, may be exempted from an income tax under the broad powers to classify an excise tax.

C. Summary of Revenue Provisions of Selected States

1. California—Property Taxes

Real Property. Taxation of real property is governed by Article XIII, Section 1, of the California constitution which provides that "all property in the State . . . shall be taxed in proportion to its value." Under this provision, real property is subject to taxation by a strict rule of uniformity.

Personal Property. Article XIII, Section 14 of the constitution authorizes the classification of personal property, tangible and intangible, in very broad terms. Under these provisions, the legislature may tax tangible and intangible personal property "in such manner, and at such rates, as may be provided by law" and "may classify any and all kinds of personal property for the purposes of assessment and taxation in a manner and at a rate or rates in proportion to value different from any other property in this state subject to taxation and may exempt entirely from taxation any or all forms, types or classes of personal property."

It will be observed that the power to classify specifically includes the power to exempt personal property from taxation. Pursuant to this authority, the legislature has exempted most intangibles from taxation. The license fee upon automobiles is imposed in lieu of an ad valorem property tax.[216]

Excise Taxes. The imposition of excise taxes falls within the plenary power of the legislature and need only operate uniformly as to class. Article XIII, Section 11, grants the legislature complete freedom in the imposition of an income tax: "Income taxes may be assessed to and collected from persons, corporations, joint-stock associations, or companies resident or doing

[216] Cal. Rev. & Tax Code § 10758.

business in the state, or any one or more of them, in such cases and amounts, and in such manner, as shall be prescribed by law."

Exemptions. The exemption of real property from taxation is limited to those items specifically authorized by constitutional provision, and the California constitution includes numerous provisions relating to exemptions. Personal property, on the other hand, may be exempted under the authority to classify. The property of qualified pension trusts is exempt from tax by specific statutory provision.[217]

2. Florida—Property Taxes

Real Property. Article IX, Section 1 and Section 5, of the Florida constitution provide a general rule of uniformity with respect to the ad valorem taxation of real and personal property. Section 2, however, reserves the ad valorem taxation of real and tangible personal property for the local governmental units.

Although the constitutional provisions do not authorize general classification of real property for ad valorem taxation. the homestead exemption of $5,000 of assessed valuation provided by Article X, Section 7, results in some degree of classification.

Personal Property. As a general rule, all personal property is subject to ad valorem taxation under a strict rule of uniformity. Article IX, Section 1, however, authorizes the classification of intangibles to be taxed at a special rate not to exceed two mills on the dollar of assessed valuation. The special tax upon intangibles is in lieu of all other taxes which might be imposed upon such property.

There are two special exemption provisions which result in some measure of classification. Article IX, Section 9, provides a $500 exemption for widows and disabled residents. Article IX, Section 11, provides an exemption of $500 to the head of the family for household goods and effects. In addition to these exemptions, Article IX, Section 13, provides that the license tax upon the operation of motor vehicles shall be in lieu of all ad valorem property taxes.

Excise Taxes. There are no general constitutional provisions specifically relating to excise taxes. Consequently, excise taxes are within the plenary power of the legislature subject to the requirement that they be uniform as to class within the equal protection clause of the fourteenth amendment. There are, however, certain limitations upon the imposition of excise taxes. Article IX, Section 11, prohibits an income tax altogether and limits an inheritance tax to the amount of the credit allowed under the federal estate tax.

Exemptions. In addition to the special exemptions which bear on the question of classification as noted in the preceding comments, Article IX,

[217] Cal. Corp. Code § 28005.

Section 1, exempts from taxation "such property as may be exempted by law for municipal, education, literary, scientific, religious or charitable purposes." The property of qualified pension trusts is not exempt from taxation.

3. Indiana—Property Taxes

Real Property. The taxation of real property is governed by Article 10, Section 1, of the Indiana constitution which provides that the legislature "shall provide, by law, for a uniform and equal rate of assessment and taxation." The only exception relates to property "for municipal, educational, literary, scientific, religious, or charitable purposes, as may be specially exempted by law."

These provisions have been construed to require assessment of real property by a strict rule of uniformity[218] and to preclude exemptions except as specifically authorized. The Indiana statutes include certain exemptions of veterans, the blind, and those over 65 years of age which apparently have not been challenged, but which appear of doubtful validity in the light of the decisions.[219]

Personal Property. The rule of uniformity prescribed by Article 10, Section 1, is also applicable to the taxation of personal property. It bars classification of personal property for purposes of an ad valorem tax. This rule was recently applied to invalidate an "in lieu" tax levied upon motor vehicles at the rate of 2% of value.[220] To borrow from a recent opinion, there is "an anomaly in the constitutional history of Indiana"[221] in that a decision dating back to 1935 sustained a classified tax upon intangibles as a valid privilege tax.[222]

Excise Taxes. There is no general provision in the Indiana constitution specifically relating to excise taxes. Consequently, the legislature is free to impose excise taxes provided they operate uniformly as to class.[223] The Indiana gross income tax which provided varying rates depending upon the source of the income was sustained as an excise tax prior to the date that Article 10, Section 8 became effective.[224] The latter removes any doubt whatsoever by providing that "the general assembly may levy and collect a tax upon income from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law."

Exemptions. It is the general rule that the legislature may not exempt from ad valorem taxation property other than that authorized by Article 10, Section 1.[225] Consequently, there is no exemption of real property and tangible personal property held by a pension trust. Since intangibles have been held subject to classification under a "privilege" tax, the statute provides a specific exemption for intangible property held by a qualified pension trust.[226]

---

[218] Johnson v. Board of Park Com'rs. of Ft. Wayne, 202 Ind. 282, 174 N.E. 91 (1930).
[219] Stark v. Kreyling, 207 Ind. 128, 188 N.E. 680 (1934).
[220] Wright v. Steers, 242 Ind. 582, 179 N.E. 2d 721 (1962).
[221] Wright v. Steers, 242 Ind. at 590, 179 N.E. 2d at 725.
[222] Lutz v. Arnold, 208 Ind. 480, 193 N.E. 840 (1935).
[223] Crittenberger v. State Sav. & Trust Co., 189 Ind. 411, 127 N.E. 552 (1920).
[224] Miles v. Dept. of Treasury, 209 Ind. 172, 193 N.E. 855 (1935).
[225] Wright v. Steers, note 220, *supra*.
[226] Burns Ind. Stat. Annot. § 51-114 (1962 Supp.).

4. Iowa—Property Taxes

Real Property. The Iowa constitution contains no rule of uniformity exclusively applicable to the levy or assessment of taxes. The only uniformity requirement is that provided in the Bill of Rights: "All laws of a general nature shall have a uniform operation; the General Assembly shall not grant to any citizen or class of citizens, privileges or immunities, which, upon the same terms shall not equally belong to all citizens. In Article VIII, Section 2, it is specifically required that the property of all corporations operated for profit shall be taxed to the same extent as that of individuals.

In view of these provisions, it is apparent that the legislature is bound only by a rule of uniformity as to class, except that property of corporations may not be separately classified.[227] The legislature has not seen fit to adopt a general scheme of classification for real property, the only classification being a homestead exemption of $2,500.

Personal Property. Authority to classify personal property has been broadly exercised by the legislature and a number of classifications have been adopted. Intangibles are separately classified and taxed at a nominal rate. Motor vehicles are subject only to a vehicle registration tax which is in lieu of a property tax.

Excise Taxes. As suggested by the foregoing discussion, excise taxes are also subject only to the general requirement of uniformity as to class. Under this rule, a graduated income tax has been sustained as a valid excise.[228]

Exemptions. Exemptions from property taxes are a matter of classification. In this respect the legislature has exercised considerable restraint and the Iowa statutes provide the usual exemptions with respect to public property and property of charitable, religious and educational organizations. There is a specific exemption of property held by a qualified pension trust.[229]

5. Massachusetts—Property Taxes

Real Property. Part II, Chapter I, Section 1, Article IV of the Massachusetts constitution authorizes the legislature "to impose and levy proportional and reasonable assessments, rates, and taxes, upon all the inhabitants of, and persons resident and estates lying, within the . . . commonwealth." These provisions have been construed to require strict uniformity in the assessment of property.[230] Consequently all property included on the tax rolls must be assessed and taxed at the same rate. An exception has been provided by Amendment No. XLI, adopted in 1912, which authorizes classification of "wild or forest lands" for purposes of taxation.

Although there may be no classification with respect to property subject to taxation, exemptions have been held to be within legislative discretion subject to the rule of reasonableness.[231] Consequently, there is a wide range

[227] Hawkeye Ins. Co. v. French, 109 Iowa 585, 80 N.W. 660 (1899).
[228] Vilas v. Iowa State Bd. of Assessment & Review, 223 Iowa 604, 273 N.W. 338 (1937).
[229] Iowa Code Annot. § 427.1, para. 22.5 (1962 Supp.). (There is a one mill tax on intangibles until Korean War bonus bonds are retired.)
[230] Carr v. Assessor's of Springfield, 339 Mass. 89, 157 N.E. 2d 880 (1959).
[231] In re Opinion of the Justices, 324 Mass. 724, 85 N.E. 2d 222 (1949).

of exemptions including a homestead exemption of $2,000 for widows and persons over 70 years of age, exemptions for veterans which vary from $2,000 to $10,000, and real estate devoted to railroad use to the extent of 60% of the 1961, 1962 and 1963 real estate taxes if the net income of the railroad in the year immediately preceding the tax year is less than $25,000.

Personal Property. As indicated in the comments relating to real property the legislature cannot classify personal property for purposes of taxation so that different classes of personal property might be assessed at different rates. The legislature, however, has exercised its broad power to exempt personal property from taxation. Illustrative of the exercise of the power is the exemption of household furniture and effects in the amount of $5,000, wearing apparel and farm machinery in the amount of $1,000, and cash on hand and tools of a trade. The exemption of household furniture and effects which was increased in 1951 from $1,000 to $5,000 was sustained as a reasonable exercise of legislative authority.[232] It should be noted that motor vehicles are exempt under the general property tax, the legislature apparently having decided that such vehicles are adequately taxed by license fees and motor fuel taxes.[233]

Excise Taxes. By Part II, Chapter I, Section 1, Article IV of the constitution, the legislature is authorized "to impose and levy, reasonable duties and excises, upon any produce, goods, wares, merchandise, and commodities, whatsoever, brought into, produced, manufactured, or being within" the commonwealth. This provision has been construed to require uniformity only as to class. It will be observed, however, that this language does not authorize the imposition of excise taxes in broad general terms. At first, it appeared that these provisions would be interpreted broadly to permit taxation of all privileges; but later the court withdrew to the position that the legislature could not impose an excise tax upon the exercise of common or natural rights.[234]

In 1915, the Massachusetts court ruled in an advisory opinion that an income tax was a property tax and would be subject to the uniformity requirements of the constitution.[235] By Amendment No. XLIV, adopted the same year, the legislature was empowered to levy an income tax at different rates on income derived from different classes of property, to tax earned income at a lower rate than investment income, and to adopt reasonable exemptions. The amendment also provided that any class of property the income from which is taxed under an income tax may be exempted from ad valorem property taxation. The court has subsequently ruled that the amendment did not change the nature of the income tax as a property tax and that since there is no authorization of graduated rates, the uniformity

---

[232] Newhall v. Assessors of Brookline, 329 Mass. 100, 106 N.E. 2d 432 (1952).

[233] Mass. Ann. Laws ch. 60A, § 1 (1961).

[234] See Maguire, *Taxing the Exercise of Natural Rights*, Harvard Legal Essays 273, 275-82 (1934).

[235] In re Opinion of the Justices, 220 Mass. 613, 108 N.E. 570 (1915).

provisions apply and each class of income must be taxed at a flat rate.[236]

Exemptions. As indicated in the foregoing discussion, the exemption of property from ad valorem taxation is one of reasonable classification. The Massachusetts statutes specifically exempt the property of qualified pension trusts provided the trust operates under a contributory plan.[237]

6. Michigan—Property Taxes

Real Property. Under Article IX, Section 3, of the new Michigan constitution, "the legislature shall provide for the uniform general ad valorem taxation of real and tangible personal property not exempt by law." The legislature is also authorized to impose "in lieu" taxes with respect to "designated real and tangible personal property," provided "every tax other than the general ad valorem property tax shall be uniform upon the class or classes on which it operates." It is further provided that the assessment ratio under a general property tax shall not exceed 50 percent of true cash value.

Under these provisions, it is clear that there can be no classification of real property for purposes of an ad valorem tax. An ad valorem tax must be imposed under the strict rule of uniformity. Classification could be accomplished, however, by the use of "in lieu" taxes, provided the "in lieu" taxes operated uniformly as to the class or classes of real property selected for such taxation.

Personal Property. As indicated above, tangible personal property is subject to ad valorem taxation on a strictly uniform basis in the same manner as real property. But designated items of tangible personal property may be selected for "in lieu" taxes, provided such taxes are uniform upon the selected class or classes. This would permit, for example, the removal of automobiles and trucks from the personal property tax rolls with the imposition of state license taxes "in lieu" of ad valorem property taxes. There is no authority under Article IX, Section 3, for the imposition of an ad valorem tax upon intangible property.

Excise Taxes. Excise taxes would fall within the plenary taxing power of the state and would be subject to the general requirement of uniformity as to class under the equal protection clause of the fourteenth amendment. There are no general provisions in the new constitution relating to excise taxes, but certain specific limitations and restrictions have been adopted. Article IX, Section 7, provides that "no income tax graduated as to rate or base shall be imposed." Section 8 fixes a maximum rate of 4% upon the imposition of a retailers' sales tax on the sale of tangible personal property. In addition to these limitations, there are several provisions which ear-mark certain tax revenues for specific purposes.

Exemptions. The only specific constitutional provision relating to tax exemptions appears in Article IX, Section 4, as follows: "Property owned and occupied by non-profit religious or educational organizations and used ex-

---

[236] In re Opinion of the Justices, 266 Mass. 583, 165 N.E. 900 (1929).
[237] Mass. Ann. Laws ch. 32, § 41 (1961).

clusively for religious or educational purposes as defined by law, shall be exempt from real and personal property taxes." This provision is mandatory in terms and requires the exemption of property of non-profit educational and religious organizations based on ownership, occupancy, and use. The legislature is given authority, however, to define the property which falls within this classification. Other exemptions would apparently be permitted under Section 3, of Article IX, which provides for ad valorem taxation of real and tangible personal property "not exempt by law." Additional exemptions would have to meet the requirement of uniformity as to class. Intangibles held by a qualified pension trust are exempt from tax.

7. Minnesota—Property Taxes

Real Property. The taxation of real property is governed by Article IX, Section 1, of the Minnesota constitution which provides that "taxes shall be uniform upon the same class of subjects." Under these provisions, the legislature may classify property so that different classes are assessed at different rates. Pursuant to this "wide-open" authority, the legislature has broadly classified real property not only by nature or use but also by value.

Personal Property. Under the foregoing provisions of Article IX, Section 1, personal property is also subject to classification and has been broadly classified by statutory provision. Specific provisions in Article 16, Section 9, and Article 19, Section 4, respectively, specifically authorize the imposition of "in lieu" taxes upon motor vehicles and aircraft on a more onerous basis than other personal property.

Excise Taxes. Excise taxes are within the broad scope of Article IX, Section 1, and need only be uniform as to the class. A graduated net income tax has been sustained as falling with these provisions.[238]

Exemptions. Article IX, Section 1, provides that "public burying grounds, public school houses, public hospitals, academies, colleges, universities, and all seminaries of learning, all churches, church property and houses of worship, institutions of purely public charity, public property used exclusively for any public purpose, shall be exempt from taxation." These provisions have been construed as inapplicable to investment real estate owned by a church, the income from which was applied to support church activities.[239] Real property and tangible personal property held by a pension trust are subject to taxation, but intangibles are exempt.

8. Missouri—Property Taxes

Real Property. Article 10, Section 3, of the Missouri constitution provides that taxes "shall be uniform upon the same class of subjects within the territorial limits of the authority levying the tax." But Article 10, Section 4(a), places all real property in a single class so that there may be no classification of real property for assessment at different rates. Forestry lands are specifically placed in a separate class by Article 10, Section 7.

---

[238] Reed v. Bjornson, 191 Minn. 254, 253 N.W. 102 (1934).

[239] State v. Union Congregation Church, 173 Minn. 40, 216 N.W. 326 (1927).

Personal Property. Article 10, Section 4(b), authorizes the legislature to classify both tangible and intangible personal property and provides that intangibles shall be taxed by yield at a rate not to exceed 8%.

Excise Taxes. General authority to impose excise taxes is provided in Article 10, Section 4(a): "Nothing in this section shall prevent the taxing of franchises, privileges or incomes, or the levying of excise or motor vehicle license taxes, or any other taxes of the same or different types." Prior to the adoption of these provisions in 1945, the Missouri court had sustained a graduated income tax as a valid excise tax.[240]

Exemptions. Article 10, Section 6, governs the exemption of property from taxation. Property owned by the state and its political subdivisions and the property of nonprofit cemeteries are exempt by the terms of Section 6. In addition, the legislature is authorized to exempt by general law "all property, real and personal, not held for private or corporate profit and used exclusively for religious worship, for schools and colleges, for purposes purely charitable, or for agricultural and horticultural societies." Property of qualified pension trusts is not exempt from tax.

9. New Jersey—Property Taxes

Real Property. Article VIII, Section 1, Paragraph 1, of the New Jersey constitution provides as follows:

> "Property shall be assessed for taxation under general laws and by uniform rules. All real property assessed and taxed locally or by the State for allotment and payment to taxing districts shall be assessed according to the same standard of value; and such real property shall be taxed at the general tax rate of the taxing district in which the property is situated, for the use of such taxing district."

These provisions have recently been construed to require a strict rule of uniformity as to each taxing district in the taxation of real property. On this basis, a statute which provided that the value of acreage devoted to agricultural uses "shall not be deemed to include prospective value for subdivisions or nonagricultural use" was held invalid.[241] Article VIII, Section 1, Paragraph 3, provides a special veteran's exemption of $500 with respect to taxation of real and personal property and authorizes the legislature to grant additional exemptions for the benefit of disabled veterans.

Personal Property. With respect to personal property, it has been held that the foregoing provision of Article VIII, Section 1, Paragraph 1, only requires uniformity as to class. The restriction as to strict uniformity is limited by the terms of the constitutional provision solely to real property. Thus statutory provisions authorizing municipalities to exempt household goods from taxation and providing for the assessment of farm machinery, livestock and produce at one-fourth the assessment rate applicable to business machinery and equipment were held to be valid classifications.[242] Since personal property may be classified for tax purposes, motor vehicles are taxed

[240] Bacon v. Ranson, 331 Mo. 985, 56 S.W. 2d 786 (1932).
[241] Switz v. Kingsley, 37 N.J. 566, 182 A. 2d 841 (1962).
[242] *Id.*

on an "in lieu" basis by exempting from the personal property tax those vehicles upon which registration fees have been paid. Intangibles are exempt from taxation.

Excise Taxes. There is no specific provision in the New Jersey constitution relating to excise taxes and such taxes are within the plenary power of the state. Consequently, excise taxes need only meet the requirement of uniformity as to class. New Jersey has not adopted a general income tax although there is ample authority therefor.

Exemptions. The constitution of 1947 does not expressly define the areas in which tax exemption may be granted, but Article VIII, Section 1, Paragraph 2, requires that "exemption from taxes may be granted only by general laws." It is further provided that existing exemptions may be altered or repealed except with respect to property used exclusively for religious, educational, charitable, or cemetery purposes and owned by not-for-profit corporations organized exclusively for such purposes.

Although the constitution does not permit classification of real property, so that different classes may be assessed at different rates, the exemption of property from taxation is deemed a matter of classification. New Jersey legislation follows the usual pattern with respect to the exemption of public property and property used for educational, religious and charitable purposes. Real and tangible personal property owned by a qualified pension trust is taxable, but intangibles, except bank stock, are exempt.

10. New York—Property Taxes

Real Property. The New York constitution, Article XVI, Section 2, contains the following provision with respect to the imposition of a general property tax: "The legislature shall provide for the supervision, review and equalization of assessments for purposes of taxation. Assessments shall in no case exceed full value." There is no uniformity requirement other than that of the equal protection clause in the Bill of Rights and a requirement in Article XVI, Section 1, that "exemptions from taxation may be granted only by general laws."

Under these provisions it is recognized that the legislature is free to classify real property for tax purposes,[243] but the general rule adopted by statute is to tax real property on a uniform basis.[244] The only exception relates to exemptions which, as indicated above, are granted by general law. In addition to the exemptions customarily granted with respect to the property of public, charitable, educational, and religious institutions, special provisions apply to forest lands, property owned by veterans, and railroad property. To this extent, New York has adopted a limited classification of real property.[245]

---

[243] "Although it is fundamental that the legislature may classify property for tax purposes in any manner it deems proper . . . its power in that regard is not without limitation, for the classification must have some reasonable basis." Grumman Aircraft Eng. Corp. v. Board of Assessors, 2 N.Y. 2d 500, 141 N.E. 2d 794, 797, *motion for reargument denied, motion to amend remittitur granted,* 2 N.Y. 2d 1012, 143 N.E. 2d 352 (1957), *cert. denied,* 355 U.S. 814, 78 Sup. Ct. 14, *rehearing denied,* 355 U.S. 885, 78 Sup. Ct. 145 (1957).

[244] N.Y. Real Property Tax Law, § 300 and § 306.

[245] N.Y. Real Property Tax Law, § 480 (forest lands), § 458 (veterans), and §§ 476-476(d).

Personal Property. New York imposes no property taxes upon personal property, either tangible or intangible. The exemption of intangible property is provided by Article XVI, Section 3: "Intangible personal property shall not be taxed ad valorem nor shall any excise tax be levied solely because of the ownership or possession thereof, except that the income therefrom may be taken into consideration in computing any excise tax measured by income generally." Under these provisions, income from intangibles may be included in the base of a general income tax, but ad valorem taxation of intangibles is clearly prohibited. The legislature as a matter of policy has determined that tangible personal property as well as intangible shall be free from ad valorem taxation by providing that "personal property, whether tangible or intangible, shall not be liable to ad valorem taxation."[246]

Excise Taxes. Under the New York constitution, excise taxes need only be uniform as to the particular class. New York has adopted a graduated net income tax.

Exemptions. As indicated in the preceding discussion, exemptions may be granted only by general law so that the question is one of reasonableness of classification. The provisions exempting real property from taxation have been construed as inapplicable to real property held as an investment by a tax exempt organization.[247] All property of qualified pension trusts is exempt from taxation.

11. Ohio—Property Taxes

Real Property. The taxation of real property is governed by Article XII, Section 2, of the Ohio constitution which provides that "land and improvements thereon shall be taxed by uniform rule according to value." Under this provision, it is required that real property be taxed by strict rule of uniformity and there may be no classification.

Personal Property. The uniformity provisions of Article XII, Section 2, do not apply to personal property. Consequently, personal property may be assessed and taxed at different rates. Thus, Ohio has adopted a comprehensive scheme of classifying both tangibles and intangibles. Intangibles are taxed on the basis of yield in the case of investments, otherwise on the basis of value. Registered motor vehicles are exempt from ad valorem property taxes.

Excise Taxes. The Ohio constitution includes several provisions relating to excise taxes. Article XII, Section 10, provides that " laws may be passed providing for excise and franchise taxes and for the imposition of taxes upon the production of coal, oil, gas and other minerals." In addition, Sections 7, 8, and 9, respectively, authorize the imposition of graduated inheritance and income taxes, and provide that not less than 50 percent of such taxes shall be returned to the local governmental units. Section 5a of Article XII requires ear-marking of motor vehicle license fees and motor fuel taxes

---

[246] N. Y. Real Property Tax Law, § 300.

[247] See Pace College v. Boyland, 4 N.Y. 2d 528, 151 N.E. 2d 900 (1958).

for highway purposes. Finally, Section 12 prohibits the levy of an excise tax upon the sale of food for consumption off the premises of the vendor.

Exemptions. Article XII, Section 2, authorizes the exemption of property of charitable, religious and educational organizations. Investments subject to the intangibles tax do not include an interest in a qualified pension plan.

12. Pennsylvania—Property Taxes

Real Property. Article IX, Section 1, of the Pennsylvania constitution provides that "all taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax. . . ." This is followed by a comprehensive list of the types of property which the legislature may exempt from taxation by general law. The provisions in Section 1 relating to exemptions are made exclusive by Section 2 which provides that any other exemptions shall be void.

Under these provisions, the Pennsylvania courts have sustained classifications of real property by which different classes are assessed at different rates.[248] But in view of Section 2 of Article IX, the classification permitted by Section 1, does not include the power to exempt except with respect to the particular kinds of property enumerated therein.

Personal Property. The Pennsylvania court has construed Article IX, Section 1, to permit classification of personal property so that different classes may be assessed at different rates.[249] The authority to classify has also been extended to the exemption of items of personal property. Tangible personal property is not taxed.

Excise Taxes. The Pennsylvania constitution includes no specific provision relating to excise taxes. Consequently, the legislature is free to impose excise taxes provided such taxes are uniform as to class. The Pennsylvania court has taken the position, however, that the rule of uniformity prescribed by Article IX, Section 1, precludes the imposition of graduated taxes. Thus the court has held a graduated inheritance tax invalid.[250] The position of the Pennsylvania court in applying the rule of uniformity to bar graduated excise taxes is unique and contrary to the manifest weight of authority.

In 1935, Pennsylvania enacted a graduated individual income tax which was declared unconstitutional under the uniformity provisions of Article IX, Section 1. The court concluded that the tax upon income from real and personal property was in effect a tax upon the property itself. Consequently, the exemption provisions and graduated rates resulted in a violation of the uniformity requirements.[251] The court reserved judgment as to the validity of an income tax upon income derived from occupations, trades, or professions.

Exemptions. As previously noted, exemptions of real property are strictly governed by Article IX, Section 1, but exemptions of personal property are within the broad powers of legislative classification. The usual exemptions of

[248] Jermyn v. Scranton, 212 Pa. 598, 62 Atl. 29 (1905).
[249] Heisler v. Thomas Colliery Co., 274 Pa. 448, 118 Atl. 394 (1922).
[250] In re Cope's Estate, 191 Pa. 1, 43 Atl. 79 (1899).
[251] Kelley v. Kalodner, 320 Pa. 180, 181 Atl. 598 (1935).

real property provided with respect to charitable, educational, and religious property are strictly construed. Real property owned by a pension trust is taxed, but tangible and intangible personal property are exempt.

13. Texas—Property Taxes

Real Property. Article VIII, Section 1, of the Texas constitution prescribes a strict rule of uniformity with respect to ad valorem property taxes. There is no general authorization for classification of either real or personal property and exemptions are generally limited by the provisions of Article VIII, Section 2. There is limited classification of real property under Article VIII, Section 1a, in that the first $3,000 of a residential homestead is exempt from county taxes.

Personal Property. As indicated in the preceding paragraph, it is the general rule that all property, real and personal, tangible and intangible, is constitutionally subject to ad valorem taxation by strict rule of uniformity. With respect to personal property, there are two exceptions to this general rule: (1) Article VIII, Section 1, exempts household and kitchen furniture in the amount of $250, and (2) Article VIII, Section 19, exempts farm products in the amount of $250 in the hands of the producer, and family supplies for home and farm use.

Excise Taxes. Article VIII, Section 1, authorizes the imposition of "occupation" taxes with the exception that "persons engaged in mechanical and agricultural pursuits shall never be required to pay an occupation tax." The term "occupation tax" has been construed to embrace excise taxes generally. Justification for this broad construction is to be found in Article VIII, Section 17, which provides that "the specification of the objects and subjects of taxation shall not deprive the Legislature of the power to require other subjects or objects to be taxed . . . ."

In addition, it is provided that the legislature may "tax incomes of both natural persons and corporations." Under Article IX, Section 2, excise taxes are subject to the requirement that they be "equal and uniform upon the same class of subjects within the limits of the authority levying the tax." By Article 8, Section 7a, motor vehicle and motor fuel taxes are ear-marked for highway and school purposes.

It is apparent that the legislature has broad powers with respect to the imposition of excise taxes. As yet, however, the legislature has not imposed an income tax.

Exemptions. In general, Article VIII, Section 2, authorizes the exemption of public property, property of religious organizations used for worship or as parsonages, non-profit burial grounds, property used for school purposes, endowment funds of educational and religious institutions, and property of institutions of public charity. The exemption of endowment funds of educational and religious institutions does not extend to investments in real property except for a period of two years where the property has been acquired by mortgage foreclosure. All property held by a pension trust is

generally subject to taxation; however, intangibles are usually not assessed and the statute specifically exempts shares of stock of corporations whose property is listed for taxation.

14. Wisconsin—Property Taxes

Real Property. Article VIII, Section 1, of the constitution specifies that the "rule of taxation shall be uniform." It is further provided that "taxes shall be levied upon such property with such classifications as to forests and minerals including or separate or severed from the land, as the legislature shall prescribe." Under these provisions, it has been held that the legislature has the power to classify for purposes of exemption, but may not classify for purposes of assessment. Consequently, all property, real and personal, which is subjected to taxation must be assessed on the same basis and must be taxed at the same rate.[252]

Personal Property. The same general rules which are applicable with respect to the assessment and taxation of real property are also applicable with respect to personal property. However, Article VIII, Section 1, was amended in April, 1961 to permit classification of inventories by assessment on the basis of average value: "Taxation of merchants' stock-in-trade, manufacturers' materials and finished products, and livestock need not be uniform with the taxation of real property and other personal property, but the taxation of all such merchants' stock-in-trade, manufacturers' materials and finished products and livestock shall be uniform, except that the legislature may provide that the value thereof shall be determined on an average basis." The legislature has freely exercised its power to exempt property from taxation. Intangibles and motor vehicles are among the items exempt from ad valorem taxation.

Excise Taxes. Article VIII, Section 1, authorizes the imposition of excise taxes in broad terms: "Taxes may also be imposed on income, privileges and occupations, which taxes may be graduated and progressive, and reasonable exemptions may be provided." The provisions authorizing the imposition of a general income tax were added by amendment in 1908 and the first income tax statute was sustained in 1912.[253] Under these provisions of the constitution, it is only necessary that an excise tax operate uniformly as to the particular class.

Exemptions. As indicated in the preceding comments, the exemption of property from taxation is within the legislative discretion to classify. Thus, exemptions must be based upon rational and reasonable grounds.[254] Real and tangible personal property owned by a pension trust is taxable, but intangibles owned by a pension trust are exempt under the general exemption provisions.

D. Conclusion

1. Objective of Constitutional Revision. Experience under Article IX of

[252] State *ex rel* Baker Mfg. Co. v. Evansville, 261 Wis. 599, 53 N.W. 2d 795 (1952).
[253] State v. Frear, 148 Wis. 456, 134 N.W. 673 (1912).
[254] Lawrence University v. Cutagamie County, 150 Wis. 244, 136 N.W. 619 (1912).

the constitution of 1870 has proved the undesirability of incorporating restrictions upon the legislature in the exercise of the taxing power. The General Assembly, as the representative body of the electorate, is charged with the responsibility of determining governmental programs and policy, including fiscal policy. It should be free to make these decisions in a manner wholly responsive to the particular circumstances with which the state is confronted. To limit the legislature in the determination of these matters constitutes a declaration of lack of faith in our democratic institutions and unduly hampers the effective operation of government. The point has been aptly stated in the following extract from a recent study of issues bearing on constitutional revision:

> "Ideally, a constitution should be silent on the subject of taxation and finance, thus permitting the legislature and the governor freedom to develop fiscal policies for the state to meet the requirements of their time. Obviously such a situation cannot be expected to materialize in the immediate future but that does not mean that one must be satisfied to let the existing maze of constitutional language remain as a barrier to responsible state government. Continuous resort to popular referenda on complex questions of public finance is not suited to a concept of modern day government based on the premises of representative democracy. One informed commentator, in addressing himself to the question of what a state constitution should say on the subject of taxation and finance, was prompted to comment in these words:
>
> > 'In its simplest form, the problem of what to include in the article on taxation and finance is a test of one's belief in our system of representative democracy. It is difficult to reconcile a position demanding a series of constitutional prohibitions or limitations upon the legislature's exercise of discretion in respect to taxation and finance with a real belief in democracy. Those who argue for constitutional checks are admitting a lack of belief in the capacity or desire of the elected representatives of the voters to establish and maintain an adequate and equitable system of financing public expenditures.'
>
> Before examining the nature and scope of these constitutional restrictions, comment is in order on the extent of state government fiscal activities. It is important to note that despite the elaborate limitations upon the legislature, often designed to insure fiscal prudence, state revenues, expenditures and outstanding debt have grown by leaps and bounds in these postwar years. The restrictions, which so hamper imagination and flexibility in developing fiscal programs, have not cut down on state governmental activity. What the limitations have done is to create obstacles to sound fiscal planning, management and organization."[255]

It is submitted that the objective of revenue revision should be in the direction of flexibility with a minimum of restrictions upon legislative discretion.

On this point, attention is directed to the uniformity requirement of the second clause of Section 1, Article IX, which provides that a tax upon occu-

[255] Kresky, *Taxation and Finance*, SALIENT ISSUES OF CONSTITUTIONAL REVISION, Chapter 9 (Edited by John P. Wheeler, Jr., Director State Constitutional Studies Project, National Municipal League, 1961).

pations, franchises, or privileges shall be "uniform as to the class" upon which it operates. In recent cases, this clause has been the principal basis for challenging the validity of important revenue measures which were clearly designed to achieve a greater degree of uniformity in the allocation of the tax burden under our revenue structure. In 1956, the Chicago utility tax was challenged on the ground that, as it applied to the gas company, the municipal tax violated the rule of uniformity.[256] In that case, municipal ordinances were adopted pursuant to statutory authorization which imposed taxes upon both the gas and electric companies at a rate of 5 percent of gross receipts. With respect to the electric utility, however, a credit was allowed for a 4 percent franchise fee measured by gross receipts which was imposed for the use of the city streets. No credit was provided for the gas company since it was not required under the terms of its perpetual charter to pay for the use of the streets. Thus, the two utility companies were each paying an aggregate tax and franchise fee of 5 percent of gross receipts. Nevertheless, the tax upon the gas company was challenged on the ground that there was a violation of the rule of uniformity.

The following year, in 1957, the use tax which complements the retailers' occupation tax and equalizes the tax burden as between those who purchase goods within the state and those who purchase goods without the state very nearly failed as a consequence of an attack based on the uniformity provision.[257] It was argued that since the use tax was strictly complementary to the retailers' occupation tax, it would apply to a ready-made suit purchased out of state but not to a tailor-made suit purchased out of state. On this ground, it was contended that the use tax operated in a discriminatory manner.

In neither of these cases was the legislative body acting arbitrarily. On the contrary, the city council in the first case and the General Assembly in the second were attempting to effect equality in the tax burden. In each case, the challenge to the tax failed. However, in the light of these and other cases, it is pertinent to inquire as to whether the uniformity provision relating to excise taxes is essential to the protection of the taxpayer. On the record there is ample justification for concluding that it merely provides an avenue for harassment and a stumbling block for the General Assembly in its efforts to resolve the fiscal problems of the state. Without these provisions, taxpayers are adequately protected against arbitrary classification by the equal protection clause of the fourteenth amendment. Such states as California, Iowa and New York have managed without a specific rule of uniformity applicable to excise taxes.

2. Observations with Respect to Present Provisions and Need for Amendment. As indicated in Part I of this study, there have been indications of a significant change in the judicial construction of Article IX with

[256] Peoples Gas Co. v. City of Chicago, 9 Ill. 2d 348, 137 N.E. 2d 330 (1956).
[257] Turner v. Wright, 11 Ill. 2d 161, 142 N.E. 2d 84 (1957).

respect to excise taxes. The broadened construction of "taxable privilege" and the wider range allowed in the classification of excise taxes suggests that an amendment of Article IX may not be necessary to validate a general income tax or privilege taxes measured by income.[258] It is also reasonably likely that the sale of food for consumption off the premises of the vendor could be validly excluded from the retailers' occupation and use taxes.[259]

One of the most serious inequities in our present tax structure arises from the fact that a substantial amount of intangible personal property is omitted from the property tax rolls and as a consequence bears none of the cost of local government.[260] At the same time, automobiles and household furnishings are heavily taxed in many areas of the state. There are two alternatives for dealing with this problem. One is the adoption of a classified property tax which would permit taxation of intangibles on the basis of yield. However, this would require a constitutional amendment. A constitutional amendment would also be required to permit the imposition of license taxes upon motor vehicles in lieu of a property tax and to authorize the exemption of household furnishings. The alternative to a classified property tax to reach intangibles is the adoption of a general state income tax or a special state privilege tax upon the receipt of income from intangibles. On this point, a persuasive case can be made for completely abolishing the personal property tax and substituting a general state income tax.[261] In this manner, maximum equality in the taxation of all personal property, both tangible and intangible, would be achieved by taxing both classes of personal property solely on the basis of income. To accomplish this objective, constitutional amendments would be necessary to authorize the abolition of the personal property tax and to enable the General Assembly to allocate state revenues to the local governmental units for any purpose it deemed necessary to offset the losses of revenue from the personal property tax.[262]

---

[258] See discussion pp. 362-73 *supra*.

[259] See discussion pp. 397-403 *supra*.

[260] An analysis of the property tax burden in Illinois for the year 1960 provides the following information:

Type of Property	Equalized Assessed Valuation (Billions)*	Percent of Total Assessments
Real Property	$27.55	80.3%
Personal Property		
Tangible	5.70	16.6%
Intangible	1.07	3.1%
Total	$34.32	100.0%

*SOURCE: Allen, *General Property Tax*, Table III p. 456 and Table VI p. 472 *infra*.
(Intangible personal property includes money, net credits, stocks and bonds, all other personal property, capital stock, and bank stock as listed in Table VI.)

In round figures, 80% of the property tax burden falls upon real property and 20% upon personal property. It is particularly significant to compare the relative burden of the tax upon real property as contrasted with that on intangible personal property. As the foregoing figures reveal, the ratio is 26 to 1. In other words, the local property tax provides $26 of revenue from real property to each $1 of revenue from intangible personal property. This comparison provides dramatic confirmation of the extensive omission of intangible property from the property tax rolls and the fact that intangible personal property bears only a minor portion of the cost of local government.

[261] New York is a notable example of a state which has discarded the personal property tax.

[262] The Commission's proposed constitutional amendment would permit the classification of intangible personal property [Section 2A, paragraph (3)], in lieu license taxes upon automobiles [Section 2A, paragraph (2)], the exemption of household furnishings (Section 3), or the complete abolition of the personal property tax. If a state income tax were adopted, the General Assembly would be required to abolish the tax on personal property within four years [Section 2A, paragraph (6)].

If a constitutional amendment were to specifically authorize the imposition of an income tax, it should include a provision to permit the General Assembly to incorporate by reference the present or prospective provisions of the federal income tax.[263] This would greatly facilitate the administration of a state income tax, whether based on gross or net income and whether imposed on a flat rate or graduated basis. Both New York and Colorado have recently adopted amendments of this type.[264] Taxpayers find it extremely inconvenient to prepare a federal income tax return on one basis and a state income tax return on an entirely different basis. Furthermore, the cost of administering a state income tax can be held to a minimum by basing the tax principally upon income as determined under the federal provisions.

It has been generally conceded that the present 5% limitation upon bonded indebtedness in Section 12, Article IX, is too restrictive with respect to 12-grade unit school districts and that the rate should be increased to 8%. It is also recognized that, if the personal property tax were abolished, the property tax rolls would be depleted by approximately 20% and that proper adjustment should be made by increasing the general debt limitation from 5% to 6% and the rate applicable to 12-grade unit school districts from 8% to 10%.[265]

Certain miscellaneous items relating to constitutional revision should be noted. It is desirable to exempt intangible personal property held in qualified pension trusts from the personal property tax. As indicated in the comparative study of fourteen states, most jurisdictions grant this type of property tax exemption to qualified pension trusts which are exempt under the federal income tax laws.[266] If the personal property tax were abolished, a specific exemption of such property would not be required.

One of the proposals which was made to the Commission was to change the language of Section 10, Article IX, which presently requires the "corporate authorities to levy taxes for the payment of *debts contracted* under authority of law," to provide that the "corporate authorities" shall levy taxes "for the payment of *liabilities incurred* under authority of law."[267] In the absence of any apparent or compelling necessity, it is inadvisable to change the present language of Section 10. The proposed change might open the door to liability upon outstanding tax anticipation warrants where the tax funds against which they were issued have been exhausted.[268]

---

[263] Such a provision might read as follows: "The General Assembly may define income for purposes of an income tax or a tax measured by income. In either case, the General Assembly may define income by reference to the laws of the United States in effect from time to time, whether retrospective or prospective, and may provide exceptions or modifications to such laws."

[264] See discussion at pp. 373-80 *supra*.

[265] The Commission's proposed amendment of Section 12, Article IX makes these adjustments.

[266] The Commission's proposed amendment of Section 3, Article IX, authorizes the exemption of intangible personal property of pension trusts.

[267] This proposed change in the language of Section 10 was incorporated in the proposed (identical) amendments of Article IX which were submitted to the voters and rejected in 1952 and 1956. Ill. Laws 1951, at 2138; Ill. Laws 1955, at 2291.

[268] Berman v. Bd. of Educ., 360 Ill. 535, 196 N.E. 464 (1935). In the *Berman* case the court held that "tax anticipation warrants are not contracts and the municipality is not indebted as a result of their issuance." However, it might be concluded that the taxing body nevertheless had "incurred a liability" within the scope of the proposed change in the language of Section 10.

The Commission has expressed its concern with respect to the burden of local property taxes. The allocation of state funds to the local governmental units is an effective method of providing relief to the local property owners. It is essential, therefore, that the General Assembly have authority to allocate state revenues to the local governmental bodies for whatever purposes it may deem necessary. Under the present provisions of Section 10, the General Assembly is precluded from imposing taxes upon municipal corporations, or the inhabitants or property thereof "for corporate purposes" as distinguished from a general state purpose.[269] To resolve any question with respect to the allocation of state revenues, it is recognized that Section 10 should be amended.[270]

[269] People v. Schlaeger, 391 Ill. 314, 63 N.E. 2d 382 (1945).
[270] The Commission's proposed amendment of Section 10 authorizes the General Assembly to distribute state revenue to local governments for such purposes as it may direct by general law.

CHAPTER XI

STATE AND LOCAL TAX SYSTEM

By H. K. Allen*

A brief discussion of the state and local tax system should provide useful background information for consideration of the specific suggestions for revision of the tax laws which appear in later chapters. A particular tax or feature of a tax should be viewed with reference to the position which it occupies in the over-all tax system.

Taxing Powers. The taxing powers of the General Assembly are prescribed in Article IX of the Constitution of 1870.[1] In the case of *Bachrach v. Nelson*[2] in 1932, the Supreme Court of Illinois clarified the meaning of the constitutional provisions relative to taxation. The Court held that the General Assembly has power: (1) to tax property at a uniform rate; (2) to tax occupations, with the requirement that such taxes must be uniform as to class; and (3) to tax franchises and privileges, consistent with the principle of uniformity. The local governmental units have only such taxing powers as are specifically conferred upon them by the General Assembly. Several attempts have been made to amend the taxing provisions of the Revenue Article, but in each instance the proposal failed to receive the required constitutional majority. Hence the basic taxing authority is the same now as it was when the present Constitution was adopted in 1870.

Total general state revenue in 1961 amount to $1,295,722,000, with the breakdown as to the three major categories as follows:[3]

Taxes	$ 874,310,000
Charges and Miscellaneous Revenue	84,740,000
Intergovernmental Revenue	336,672,000
Total	$1,295,722,000

Sales and Use Taxes. A bird's eye view of the state tax system is presented in Table 1. It will be noted that total collections from taxes and licenses in 1961 amounted to $874,310,000. Of the total amount of tax and license revenues, $383,957,000, or 43.91 percent, was obtained from the Retailers' Occupation (Sales) Tax and the complementary Use Tax, the rates of which were 3 percent of gross receipts for the fiscal year which ended June 30, 1961. These rates were increased to 3½ percent, effective July 1, 1961.

The primary purpose of the general Use Tax is to reach tangible goods purchased by Illinois residents outside the state and shipped into the state in

*The author is Professor of Economics at the University of Illinois.

[1] For a more detailed discussion of the historical development and legal basis for the Illinois tax system, see the *Report of the Revenue Law Commission*, State of Illinois, 1949, pp. 1-29.

[2] 349 Ill. 579 (1932).

[3] U. S. Bureau of the Census, *State Government Finances in 1961*.

interstate commerce. Such purchases are not subject to the Retailers' Occupation Tax or to a sales tax levied by the state in which the seller is located. The legal incidence of the Use Tax, unlike the Retailers' Occupation Tax, is on the purchaser. The retailer is required to collect the Use Tax from users but the law provides that a retailer need not remit that part of any tax collected by him to the extent that he is required to remit and does remit the tax imposed by the Retailers' Occupation Tax with respect to the sale of the same property. In cases where Illinois has jurisdiction of out-of-state sellers the tax is collected from the seller. In other cases the purchaser is liable for direct payment of the tax to the Department of Revenue. Revenues from the increase in the rates of one-half of one percent of the sale and use taxes which became effective July 1, 1959, as well as a similar increase on July 1, 1961, are earmarked for the Common School Fund for grants-in-aid to local schools. The remainder of the revenues go to the General Revenue

TABLE 1

State Tax Collections In Illinois: 1961

	Amount	Percent
Sales and Gross Receipts		
Retailers' Occupation and Use Tax	$383,957,000	43.91
Motor Fuels	146,302,000	16.73
Alcoholic Beverages	40,612,000	4.65
Cigarettes	43,064,000	4.93
Insurance	29,040,000	3.32
Public Utilities	50,159,000	5.74
Pari-Mutuel	17,455,000	2.00
Amusement	536,000	.06
Licenses		
Motor Vehicles	102,061,000	11.67
Motor Vehicle Operators	6,595,000	.75
Corporations in General	7,557,000	.86
Public Utilities	265,000	.03
Alcoholic Beverages	1,192,000	.14
Amusements	468,000	.05
Occupations and Businesses	7,054,000	.81
Hunting and Fishing	3,351,000	.38
Other	161,000	.02
Property	1,026,000	.12
Inheritance	33,455,000	3.83
Total	$874,310,000	100.0

SOURCE: U. S. Bureau of the Census, *State Government Finances in 1961.*

Fund. In 1961 the General Assembly adopted a Service Occupation Tax and a complementary Service Use Tax. The rate of these taxes is 3½ percent and they apply to purchases of tangible personal property which is used in service occupations in connection with the sale of services.

A tax of 3 percent was also imposed in 1961 upon the leasing or renting of hotel and motel rooms by transients.

Public Utility Tax. Although imposed by separate laws to avoid constitutional difficulties, the amount of $50,159,000, or 5.74 percent, obtained from taxes on public utilities should be considered as part of general sales tax revenues. The rate of these taxes is 3 percent of gross receipts and they are imposed upon persons engaged in the business of transmitting messages; upon persons engaged in the business of distributing, supplying, furnishing or selling gas for use or consumption; and upon persons engaged in the business of distributing, supplying, furnishing or selling electricity. The statutes contain no provisions for passing these taxes on to the consumer, but like most other taxes, they do affect costs and hence rates. Revenues from the taxes on public utilities are paid into the General Revenue Fund.

Of the sum designated as revenue from public utility taxes, $3,573,000 represents revenue from a special tax on the Illinois Central Railroad. Subject to certain qualifications, the statute applicable to this company provides for payment into the State Treasury of 7 percent of gross receipts from charter lines in lieu of local property taxes or franchise tax as to that part of road included in the charter lines. Lines acquired since the charter was issued and property situated off the railroad right of way are subject to the general property tax.

Highway-User Taxes. Next to the sales and use taxes, the so-called highway user taxes produced the largest amount of revenue in 1961. The yield from the tax on motor fuels was $146,302,000, or 16.73 percent of total state tax collections. The rate of this tax is 5 cents per gallon, and the revenues after deduction of administrative costs, are shared with counties, incorporated places, and townships and are earmarked primarily for highway purposes. License fees from motor vehicles amounted to $102,061,000, or 11.67 percent of total state tax collections. Fees from motor vehicle operators amounted to $6,595,000, or 0.75 percent of the state total. Revenues from license fees are earmarked for highway purposes.

Taxes on Alcoholic Beverages. The Liquor Gallonage Tax on alcoholic beverages produced $40,612,000, or 4.65 percent of total state tax revenues in 1961. This tax is imposed upon the privilege of engaging in business as a manufacturer or as an importing distributor of alcoholic liquor at the rate of 23 cents per gallon for wine containing 14 percent or less of alcohol by volume; 60 cents per gallon for wine containing more than 14 percent of alcohol by volume, except that for wine made from grapes grown in Illinois, the tax is 8 cents per gallon for wine containing 14 percent or less of alcohol by volume and 23 cents per gallon for wine containing more than 14 percent

alcohol by volume; and $1.52 per gallon on alcohol and spirits manufactured for sale or use, or imported for sale or use. A tax of 6 cents per gallon is imposed upon the privilege of manufacturing or importing beer.

The entire schedule of gallonage taxes on alcoholic beverages was revised upward in 1959. The tax on beer was increased at that time from 4 cents per gallon to 6 cents per gallon and the tax on alcohol and spirits was increased from $1.02 per gallon to $1.52 per gallon. Revenues from the Liquor Gallonage Tax are paid into the General Revenue Fund.

Cigarette Tax. Revenues from the Cigarette Tax amounted to $43,-064,000 in 1961, or 4.93 percent of total state tax collections. This tax actually consists of three separate measures. The original law, still in effect, provides for a levy on cigarette distributors of one mill per cigarette (2 cents per package of twenty cigarettes). Revenues, less a 5 percent allowance to distributors for affixing stamps, are paid into the General Revenue Fund of the State Treasury. Revenues from an additional levy of one-half mill per cigarette (one cent for an ordinary sized package), less 5 percent discount for affixing stamps, must be paid into the Service Recognition Bond, Interest, and Retirement Fund. Revenues are used to provide for debt service on bonds issued to raise funds to pay bonuses to veterans of World War II. In addition to the above, a tax of one-half mill (one cent per pack) was imposed on July 1, 1959, to pay principal and interest on bonds issued to pay bonuses to veterans of the Korean War. When this tax expired on June 30, 1961, another levy at the same rate was adopted in its place. The combined rate of the three cigarette taxes is 4 cents per package.

The statute is silent as to shifting of cigarette taxes, but it is generally assumed that these taxes are fused into the price of cigarettes and passed along to the consumer.

A Cigarette Use Tax of one and one-half mills per cigarette is levied upon the privilege of using cigarettes in Illinois, and is designed to reach cigarettes purchased outside the state and brought into Illinois for consumption. This tax is not applicable to sales upon which the regular Cigarette Tax has been paid.

Insurance Tax. Collections from taxes on insurance companies amounted to $29,040,000, or 3.32 percent of total state tax collections in 1961. Every foreign or alien company, except fraternal benefit societies, that is authorized to do an insurance business in Illinois is subject to an annual privilege tax. The rate of this tax is two percent of the gross amount of premiums on direct business received during the preceding calendar year on contracts covering risks within the State. Certain deductions are allowed in computing taxable gross premiums. Revenues from the tax are paid into the General Revenue Fund.

The Illinois law contains a retaliatory provision which allows imposition of higher tax rates on insurance companies incorporated in states which levy higher rates on Illinois companies.

For the purpose of maintaining the State Fire Marshall's Office, an additional tax, not to exceed one-half of one percent, is levied by the Department of Insurance upon the gross premiums of all foreign and domestic fire insurance companies. Gross receipts of agencies of foreign fire insurance companies are required by Illinois statutes to be reported and taxed as personal property under the local property tax.

Pari-Mutuel Tax. The sum of $17,455,000, or 2 percent of total state tax revenues, was derived from the Pari-Mutuel Tax. Pari-mutuel is a form of betting on horse races in which those who bet on the winners share the total stakes, less a small percentage to the management. A tax of 4 percent is imposed on the total of all moneys wagered on each day of a horse running meet plus one-half the breaks. Revenues from this tax are required by law to be paid into the Service Recognition Bond, Interest and Retirement Fund in the State Treasury.

Another tax of 2 percent is imposed on the total of all moneys wagered each day of a horse (running) racing meet. Half of the revenues from this tax must be paid into the Agricultural Premium Fund, and the other half is earmarked for the Fair and Exposition Fund. Still another tax of 5 percent is imposed on the total of all moneys wagered each day of a harness racing meet, revenues from which are paid into the Agricultural Premium Fund. The statute provides that an admission tax of 20 cents shall be charged on each person who enters the grounds of a horse racing track. Revenues from this tax must be paid into the Agricultural Premium Fund.

Amusement Tax. Approximately a million dollars was collected in 1961 from taxes and licenses on various types of amusements. An annual privilege tax is imposed upon specific types of coin-in-the-slot-operated amusement devices. For pin-ball machines played exclusively for pleasure and which returns no coins, tokens, or merchandise to the player, the annual fee is $50 for each coin-receiving slot. Annual taxes on two other categories of coin-in-the-slot-operated mechanical devices are $10 and $25, respectively. Admissions to boxing and wrestling exhibitions are subject to a 10 percent tax.

Corporation Franchise Tax. The Corporation Franchise Tax is designated in Table 1 as "Licenses: Corporations in General." The yield of this tax in 1961 was $7,557,000, or 0.86 percent of total collections. With a few exceptions in the case of domestic corporations, an annual franchise tax is imposed on both domestic and foreign corporations and is based upon the estimated share of stated capital and paid-in surplus employed in the State of Illinois. Such capital and surplus is allocated on the basis of the sum of the corporate property and gross business in Illinois in comparison with the total value of all property and gross business wherever located or transacted. The rate of this tax is 1/20 of 1 percent. The statutes prescribe a progressive schedule of minimum taxes for domestic corporations ranging from $10 for corporations with stated capital and paid-in surplus of $50,000 or less to

$500 for those that have more than $10,000,000 in stated capital and paid-in surplus.

Domestic and foreign corporations are also subject to an initial or organization tax or fee the rate and base of which are the same as the annual franchise tax. The franchise tax is not to be confused with the capital stock or corporate excess tax which is applicable to domestic corporations only and which is a feature of the general property tax.

Occupation and Business Licenses. A multiplicity of specific occupations and businesses are required by law to pay license fees, registration charges, and other fees. Revenues from this category in 1961 amounted to $7,054,000, or 0.81 percent of the total. Hunting and fishing licenses produced $3,351,000 and $161,000 was derived from other licenses.

Tax on Private Car Line Companies. Whereas the State Government has not levied a general property tax since 1932, it may be surprising that Table 1 shows collections of $1,026,000 from the property tax. The great bulk of this sum was derived from a State tax which is levied on the operating personal property of private car line companies. The base of this tax includes all rolling stock, car equipment, rights, franchises, and all other intangible personal property connected with or used in the operation of any private car line companies. Private car line companies build special types of cars such as tank cars and refrigerator cars and lease them to railroads. The operating personal property of private car line companies is assessed by the State Department of Revenue. The rate of the tax is the State average property tax rate. Revenues from this tax are paid into the General Revenue Fund.

Inheritance Tax. This tax, together with the supplemental estate tax, produced $33,455,000, or 3.83 percent of total state tax collections in 1961. It is imposed upon the privilege of succession to property and is levied on the share of the estate left to each beneficiary. The law provides for four classes of beneficiaries. For lineal ancestors' descendants, the exemption is $20,000 and the rates vary from 2 percent for the first $50,000 of taxable estate to 14 percent on the amount in excess of $500,000. The exemption for a brother or sister is $10,000 and the rates are the same as for linear heirs. The exemption for an uncle, aunt, niece, or nephew is $500 and the rates vary from 6 percent on the first $20,000 of taxable estate to 16 percent on the amount in excess of $170,000. For all beneficiaries not included in the foregoing categories, the exemption is $100 and the rates progress from 10 percent on the first $20,000 of taxable estate to 30 percent on the amount over $250,000.

The inheritance tax applies generally to transfers of property by will or by intestate succession. With respect to resident decedents, it includes real estate and tangible personal property within the State and all intangible property wherever located. Gifts made in contemplation of death are sub-

ject to the inheritance tax. Any gift made within two years of death is deemed *prima facie* to have been made in contemplation of death.

In addition to the inheritance tax, a supplemental estate tax is levied in Illinois, the purpose of which is to take full advantage of the 80 percent credit provision of the basic federal estate tax.

Charges and Miscellaneous General Revenue. In addition to revenues from taxes, the State Government received $84,740,000 from charges and miscellaneous general revenue in 1961. Included among these revenues are earnings, non-license fees, and miscellaneous receipts of various state agencies. The amount represents 6 percent of total state general revenue.

Intergovernmental Revenue. The amount of $336,672,000, or 25 percent of total state general revenue was derived from intergovernmental revenue in 1961. The breakdown of this revenue is as follows:

From Federal Government		
Education	$ 31,820,000	
Highways	175,897,000	
Public Welfare	96,369,000	
Health and Hospitals	3,305,000	
Natural Resources	3,568,000	
Air Transportation	1,055,000	
Employment Security Administration	17,832,000	
Other	703,000	$330,549,000
From Local Governments		
Highways	5,802,000	
Health and Hospitals	253,000	
Other	68,000	6,123,000
Total		$336,672,000

Revenues of Local Governments. Total revenues of the local governments in 1961 amounted to $2,219,887,000. The breakdown for the three major categories are presented in Table 2.

Since the general property tax is treated in considerable detail in a later chapter, the discussion here will be limited to local taxes other than the property tax.

Revenues from the Municipal Retailers' Occupation Tax are derived from a levy of one-half of one percent upon the gross receipts from the sale of tangibles goods at retail. Cities, villages, and incorporated towns are authorized to make such a levy upon approval of the governing board of such a municipality. This tax, when levied, is collected by the State Department of Revenue. Receipts, less 4 percent to the State for the service of collecting the tax, are paid to the municipalities for general corporate pur-

poses. More than ninety percent of the municipalities in Illinois have levied such a tax. In 1961, incorporated places were authorized to levy a one-half of one percent Service Occupation Tax which is a counterpart of a similar state levy.

Revenues from the County Retailers' Occupation Tax, effective June 30, 1959, are derived from a measure similar to the Municipal Retailers' Occupation Tax. The law authorizes counties to levy a tax not to exceed one-half of one percent of gross receipts from the sale of tangible property at retail. Adoption of the measure requires approval of a majority of the members of the county board of supervisors or commissioners, as the case

TABLE 2

Local Government Revenues, 1961

Taxes	
Property Tax	$1,415,251,000
Municipal Sales Tax	55,698,000
County Sales Tax	3,173,000
Municipal Public Utility Tax	34,044 000
Insurance Tax	1,412,000
Admissions Tax	1,209,000
Total	$1,510,787,000
Charges and Miscellaneous Revenue	276,800,000
Intergovernmental Revenue	432,300,000
Total	$2,219,887,000

SOURCE: Statistics for Municipal and County Sales Tax Revenues were supplied by the Illinois Department of Revenue. Property tax revenues were estimated from statistics for earlier years. Other revenues were estimated from Bureau of the Census estimates for earlier years.

may be. The tax is not applicable to retailers who are located within the corporate boundaries of a municipality. The obvious purpose of this measure is to equalize the sales tax situation between retailers located within the boundaries of an incorporated place levying a sales tax and retailers located outside such a municipality. The revenues are collected by the State Department of Revenue, and after deduction of 6 percent for collection costs, are paid to the county levying the tax to be used for general corporate purposes. Counties were authorized to levy a Service Occupation Tax of one-half of one percent in 1961.

Revenues from the Municipal Public Utility Tax are derived from a levy, not to exceed 5 percent, which the governing boards of cities, villages, and incorporated places are authorized to impose on gross receipts from:

1. Business of transmitting messages by means of electricity.

2. Business of distributing, supplying, furnishing, or selling gas for use or consumption.
3. Business of distributing, supplying, furnishing, or selling electricity for use or consumption.
4. Business of distributing, supplying, furnishing, or selling water for use or consumption.

This tax has as yet been levied by only a few municipalities. A few cities recently adopted the measure to recoup a loss of revenue from a reduction in maximum property tax rate limits for specific municipal purposes brought about by a Supreme Court decision.

A small amount of revenue is obtained by local governments from an Insurance Tax. Every agent of any foreign or alien company is required to return to the proper officer of the county, town, or municipality in which the agency is established in the month of May annually the amount of the net receipts of such agency for the preceding year from fire and marine insurance. Any such amounts as equalized, must be listed on the tax lists of the county, town, or municipality, and are subject to the same basis and rate of taxation for all purposes, state, county, town and municipal, that other personal property is subject to at the place where located. Revenues from this tax are included in personal property tax collections.

Cities and villages in Illinois are authorized to levy a cigarette tax not to exceed one cent per package of twenty cigarettes. An important provision of the enabling legislation is that no municipality may levy a cigarette tax during any period in which a municipal retailers' occupation tax is in force. This limitation, together with the fact that most cities levy a retailers' occupation tax, leaves the cigarette tax available to only a few cities. Information is not available as to how many cities, if any, levy such a tax, or the amount of revenue derived therefrom. It is believed, however, that any revenues from this source are inconsequential.

Revenues from charges and miscellaneous sources include motor vehicle license fees (wheel taxes); alcoholic beverage license fees; license fees from other specific types of business; building and equipment permits; inspection fees; parking meters; earnings of municipally-operated public utilities; and fines.

Intergovernmental revenue consists of state financial assistance for education, highways, public welfare, hospitals, health, natural resources, airports, and other purposes. More than half of the total amount of intergovernmental revenue in 1961 was for education. Some double counting occurs between State and local intergovernmental revenues.

Some Guidelines

In suggesting revisions in the state and local tax system in Illinois, several basic principles should be kept carefully in mind. Each proposed revision should be considered with reference to its impact upon the over-all

tax system and the allocation of revenues among state and local levels of government. It is not expected that every tax should meet all the requirements of a good tax system, but the state and local tax system as a whole should comply with the standards indicated.

Equitable Distribution of Tax Burdens. One of the primary requisites of a good tax system is that tax burdens should be distributed among the citizens in a fair and equitable manner. This is necessary first of all as a matter of simple justice. It is essential, moreover, to a strong and enduring system of government. Finally, an equitable distribution of tax burdens is required for the maintenance of a growing and prosperous economy.

With few exceptions, economists are agreed that the progressive individual income tax is the most equitable of all taxes. The Federal Government places heavy emphasis upon this source, and it is used moderately by approximately thirty states.

In analyzing the distribution of tax burdens, it is important to keep in mind that most taxes are shifted in part, or entirely, from persons who pay them in the first instance to final purchasers. It is generally agreed that the individual net income tax and the property tax on owner-occupied homes and nonbusiness personal property cannot be shifted. Most other taxes, including part of a corporation net income tax, can be shifted.

From the standpoint of equitable distribution of state and local tax burdens in Illinois the most objectionable features are the heavy reliance placed upon the sales tax (Retailers' Occupation Tax) at the state level and the strong emphasis upon the property tax on real estate at the local level. Relative to their capacity to pay taxes, the sales tax falls more heavily upon low income families than it does upon high income families. Real estate bears a disproportionate share of the total property tax burden whereas personal property, especially intangibles, largely escapes taxation.

Productivity. Because of the large amount of revenue needed by all levels of government, it is essential that tax levying jurisdictions have access to productive sources of revenue. One of the chief advantages of the sales tax is that it is highly productive. It could be made even more productive, without increasing the rate, if the base were broadened. The motor fuel tax is also a highly productive source of revenue, but it is of course largely earmarked for use on the highways. The property tax is another highly productive source of revenue for local governmental units. This tax could be made much more productive if an effective method could be found for taxing intangibles and other types of personal property.

Despite the high rate of the Federal corporation income tax, state taxes on corporation net income produce a large amount of revenue in some states. The burden of such taxes is significantly minimized by the fact that state corporation net income taxes are deductible in computing net taxable income under the Federal law. Because of the high rates of the Federal individual income tax, state taxes of this type should not be relied upon

heavily. The case for a state tax on individual incomes rests on other grounds.

Because of the large amount of revenue needed, the bulk of state and local tax revenues must be obtained in the future as it has in the past from broadly-based, productive taxes like the sales and use taxes, the property tax, and highway-user taxes. Continued reliance upon these broadly-based taxes can be better justified, however, if appropriate measures are adopted to reach in a fair and equitable manner income from intangibles and from lucrative personal services.

Stability. Unlike the Federal Government, state and local governments must operate with balanced budgets. The importance of stable and dependable sources of revenues to these levels is readily apparent. The property tax and the sales tax rank high among the various taxes as dependable sources of revenue, the former perhaps excelling the latter in this respect. Another highly dependable source of revenue is the motor fuel tax. Among the less productive taxes, the excise tax on cigarettes ranks high in dependability. The yield from net income taxes, individual or corporate, fluctuates widely from periods of prosperity to periods of depression.

Economy of Administration. Other things being equal, it is desirable to select taxes that have a low cost of administration. Here, again, the sales tax and the motor fuel tax rank high, that is, they have a relatively low cost of administration. Specific excises, such as the cigarette tax, collected from manufacturers or distributors, have a low cost of administration. Because of the elaborate assessment and review system, the property tax has a fairly high cost of administration. This is especially true in the case of personal property. If a vigorous program should be launched to assess intangibles, the cost of administration of the property tax would rise. The income taxes have a relatively high cost of administration if compliance is carefully checked.

Convenience of Payment. It is doubtful whether taxes are ever considered by most taxpayers as being convenient to pay, but some are less inconvenient than others. The sales tax and some of the specific excises are paid on frequent purchases, usually in small amounts, and are relatively convenient to pay. That part of the individual income tax which is withheld at source is also convenient to pay. Because of the rapid increase in the property tax in recent years and the fact that this tax is payable in a single installment in the case of personalty, and in only two installments in the case of realty, the property tax is deficient from the standpoint of convenience of payment.

Tax Consciousness. It has long been asserted that citizens should be conscious of the fact that they are contributing to the costs of government. If they realize that they are paying taxes, so the argument goes, they will be less demanding of government. The objective of tax consciousness is difficult of attainment because many taxes are fused into the prices of mer-

chandise and thereby lose their identity. Among the taxes which best promote tax consciousness is the sales tax. As administered in Illinois, the tax is listed separately on the sales invoice and purchasers are constantly reminded of the fact that part of the cost of an item represents sales tax. The property tax also reminds the property owner that he is a taxpayer, but unfortunately the reminder comes at infrequent intervals. Most citizens also pay federal income taxes, but here again the reminder comes infrequently.

Simplicity. If the characteristics of a good tax system are attained, the structure will obviously not be simple. Reasonable variety is essential in a well rounded tax system. The problem is to avoid excessive complexity. With all of its serious defects in other respects, the state-local tax system in Illinois is a relatively simple one and it should be kept that way. At the state level we should continue to place primary emphasis upon a broadly-based sales tax, a few specific excises such as those upon alcoholic beverages, gasoline, and cigarettes. Possible new taxes at the state level would be on corporation and individual net income. At the local level, we should continue to rely primarily on the real estate tax and certain classes of tangible personalty. We should continue carefully to avoid the levy of a multiplicity of low-yield, nuisance taxes at either state or local levels. To the extent that they are shifted to consumers, specific excise taxes distort the normal pattern of consumer purchasing. To the extent that such taxes are not shifted, the impact upon the firms affected is discriminatory.

Neutrality. The idea of neutrality is that, so far as possible, citizens and business firms should be left in the same relative position to one another after paying taxes as they were before. Attainment of this principle requires that great caution should be exercised in singling out business concerns for special types of taxes. The risk of violating this principle can be minimized by utilizing broadly-based taxes.

It should be pointed out that the use of progressive rates does not necessarily violate the principle of neutrality. In fact, most economists agree that moderately-graduated income taxes are neutral in effect.

Earmarking of Tax Revenues. The principle that tax revenues should not be earmarked for specific purposes is widely approved by fiscal economists. Earmarking of revenues injects an element of rigidity into governmental finances and may prove embarrassing in the future. In the absence of earmarking, the legislative body can allocate all available revenues in the manner that will yield the greatest social returns. The pattern of such an allocation will vary from year to year. If earmarking is unavoidable in a particular situation, it should be temporary and by statutory enactment: never by constitutional provision.

State-Local Fiscal Relations. State and local government and finance are closely related. Any proposals to change state or local taxes must be appraised, therefore, with reference to their impact upon the over-all system.

So far as practicable, responsibility for the administration of a governmental function should go hand in hand with the responsibility for raising the revenues to finance the function. Unfortunately, only a few taxes are adapted to local administration.

It follows, then, that local government must be financed to some extent from state-administered taxes. A difficult problem arises in this connection as to ways and means of sharing state revenues with local units. It is often desirable to share some of the revenues as closely as possible in proportion to the amount collected in a particular unit. This plan would be indicated in the case of functions which are primarily of local concern. In the case of functions that are of state-wide importance, greater financial assistance should be given to poor districts than to wealthy districts. The problem of inter-governmental fiscal coordination is one of the most difficult problems in the entire field of public finance. It is complicated by the fact that part of the state taxes remitted from certain localities are not really borne by the citizens of such localities but rather by citizens of other localities. For example, the State Liquor Gallonage Tax is remitted by the distilleries from the localities in which their principal offices are located, but the actual burden of the tax falls largely upon citizens of other localities who pay the tax as part of the price that they pay for liquor. In varying degrees, a similar situation exists with respect to practically every other State tax. Shared revenues and even equalizing grants thus represent in part merely the return to localities of monies which the citizens of such communities actually paid into the State Treasury in the first place.

Legal Problems. In proposing changes in the state and local tax system, careful consideration must be given to possible legal barriers. Great caution must be exercised in the levy of a new tax measure, the constitutionality of which is seriously questionable. State governments cannot afford to run the risk of depending upon a new levy for a substantial amount of revenue when there is a strong possibility that the new revenue will be cut off midway in the fiscal year by an unfavorable court decision. As an alternative to constitutional reform, one way to test the constitutionality of a new measure would be to provide for an exceedingly low rate in the initial levy. With this approach, an unfavorable court situation would not seriously disrupt the budget and would clearly indicate whether there is a need for constitutional change. A discussion of the constitutional aspects of various proposed tax changes is presented in another chapter of this report.

Burden of State and Local Taxes

State and local taxes per $1,000 of personal income is one of the best general measures of relative tax burdens in the various states. By combining State and local taxes, recognition is given to the fact that State and local government is a joint function and that wide variations exist among the states in the allocation and financing of state-local functions between the two levels of government. A comparison of State taxes alone on a per capita

basis or even in terms of personal income gives misleading results. The same is true of local taxes when considered alone. Since taxes are paid out of income, State and local taxes per one thousand dollars of personal income provides a useful over-all measure of the burden of such taxes. The amounts for this relationship in each of the fifty states together with the United States average in 1960, are shown in Table 3.

It will be noted that Illinois, with $78.85 ranks forty-second from the highest. Only one large wealthy industrial state ranks lower than Illinois, namely, Pensylvania with $76.40. The amount for Illinois is substantially lower than the United States average of $90.29. Among the large wealthy industrial states, comparable to Illinois, which have a larger amount of state and local taxes per one thousand dollars of personal income than does Illinois are New York, with $103.11; California, with $101.48; Michigan, with $93.36; Indiana, with $82.44; and Ohio, with $78.98.

That Illinois is in an excellent position taxwise is evidenced by the fact

TABLE 3

Total Tax Revenue of State and Local Governments Per $1,000 Personal Income 1960

UNITED STATES		$ 90.29			
Vermont	1	119.67	Michigan	26	$ 93.36
Louisiana	2	117.50	Massachusetts	27	92.81
North Dakota	3	113.86	South Carolina	28	92.58
Mississippi	4	110.79	Florida	29	92.56
Montana	5	108.70	Rhode Island	30	88.69
South Dakota	6	107.56	Georgia	31	88.05
Minnesota	7	105.66	Tennessee	32	87.03
Hawaii	8	105.41	North Carolina	33	86.96
Kansas	9	105.35	West Virginia	34	86.62
Idaho	10	105.23	New Hampshire	35	85.51
Arizona	11	103.62	Texas	36	84.33
New York	12	103.11	Maryland	37	83.00
Utah	13	103.10	Indiana	38	82.44
Iowa	14	102.57	Nebraska	39	82.23
Maine	15	101.78	Alabama	40	80.44
California	16	101.48	Ohio	41	78.98
Wyoming	17	100.90	ILLINOIS	42	78.85
Colorado	18	99.63	New Jersey	43	77.63
Oregon	19	99.58	Kentucky	44	76.90
Wisconsin	20	99.35	Pennsylvania	45	76.40
Washington	21	98.43	Connecticut	46	74.41
New Mexico	22	96.71	Virginia	47	72.45
Nevada	23	96.09	Missouri	48	69.19
Oklahoma	24	95.80	Delaware	49	65.93
Arkansas	25	93.74	Alaska	50	58.19

SOURCE: *Governmental Finances in 1960*, Bureau of the Census.

that, if the citizens desired to do so, State and local taxes could be increased \$290,000,000 annually and the burden per \$1,000 of personal income would be no greater than the average for the country as a whole.

Relative to other states, the problem in Illinois is not the over-all burden of State and local taxes. The problem, as will be explained in the analysis of specific taxes, is in the inequitable distribution of the tax burden among income groups and among individuals within the same income group. Because of the heavy reliance upon gross receipts taxes, especially at the State level, the burden of the tax system of Illinois is regressive, that is, relative to incomes it falls more heavily upon lower income families than upon higher income families. Regardless of income groups, persons who own real estate or other property that is assessed bear a discriminatory burden of taxes. Finally, recipients of lucrative incomes in the form of wages, salaries, and professional fees, do not contribute to the support of State and local government in a manner commensurate with their capacity.

Information on the distribution of State and local taxes among income classes in Illinois is not available, but such information is available for the country as a whole. Estimates of this distribution are shown in Table 4.

With allowance for certain adjustments, the statistics provide a general picture of the situation in Illinois. Illinois, of course, does not levy either an individual or a corporation income tax. On the other hand, State and local taxes relative to income, as explained above, are lower in Illinois than they are for the country as a whole. Even after the foregoing facts are taken into account, it appears highly probable that the burden of State and local taxes in Illinois is fully as regressive as it is for the country as a whole. It will be noted that property taxes, as well as sale and other excise taxes, take a larger percentage of the incomes of low income families than they do of high income families. Federal taxes, because of the highly progressive rates of the federal income tax, take a higher percentage of the incomes of high income families than they do of low income families. This fact must be kept in mind in proposing changes in the State and local tax system. It limits the extent to which reliance can properly be placed upon income taxes, especially progressive taxes, at the State level. Inclusion of federal taxes results in a distribution of total taxes, relative to income, that is roughly proportional for families with incomes under \$7,500 annually.[4] Even so, the burden is greater on low income families than it is on more affluent families for the reason that the dollar has greater value to the former than it does to the latter.

Notwithstanding the fact that per capita federal, State and local taxes in Illinois rose sharply between 1942 and 1960, disposable real income (dollars of constant purchasing power) was somewhat greater in the latter year than it was in the former. Per capita total taxes in Illinois increased from

[4] Beaton, James R., "Family Tax Burdens by Income Levels," *National Tax Journal*, Vol. XV (March, 1962), p. 16.

$219.64 in 1942 to $932.04 in 1960. Disposable real income increased from $1,429.15 per capita in 1942 to $1,680.92 per capita in 1960, or 17.6 percent. In dollars of constant purchasing power, after taxes, the average citizen in Illinois was thus better off in 1960 than he was in 1942. It may be presumed, moreover, that the quantity and quality of governmental services increased during this period and that the average citizen benefited from such increases. These figures, of course, are averages and do not mean that all

TABLE 4

State and Local Taxes as a Percentage of Total Income By Source and By Income Class, 1958

Source	Family Personal Income Class							
	Under $2,000	$2,000-3,999	$4,000-5,999	$6,000-7,999	$8,000-9,999	$10,000-14,999	$15,000 And Over	Total
Individual Income	.5	.8	.6	.2	.2	.3	.7	.5
Corporation Income	.2	.2	.1	.1	.2	.2	.4	.2
Excises and Sales	4.8	3.9	3.7	3.6	3.5	3.2	2.1	3.3
Estate and Gift	—	—	—	—	—	—	.5	.1
Property	5.9	4.6	4.1	3.7	3.4	2.8	2.1	3.5
Total*	11.3	9.4	8.5	7.7	7.2	6.5	5.9	7.5

SOURCE: Tax Foundation, Inc., *Allocation of the Tax Burden by Income Class,* 1960, p. 17.
*Excludes Social Insurance.

citizens in Illinois shared in the advancement. Many citizens in Illinois were undoubtedly worse off in 1960 than they were in 1942.

State Tax Structure in Illinois and in All States

A comparison of the relative emphasis upon particular State tax and license revenues in Illinois and in all states combined reveals significant differences. The percentages of total revenues derived from major taxes and licenses in Illinois and in all states in 1961 are shown in Table 5. It will be noted that the differences are conspicuous in the case of the sales and use tax and the income taxes. Revenue from the sales (Retailers' Occupation Tax in Illinois) and use tax in Illinois amounted to 43.91 percent of the total in 1961 as compared with 23.61 percent for all states combined. Inasmuch as general sales and use taxes are considered by students of taxation as being among the most regressive of all taxes, it is especially significant that relatively heavy emphasis is placed upon these levies in Illinois.

Neither an individual nor a corporation income tax is levied in Illinois, yet for all states combined 12.36 percent of total revenues was derived from the former and 6.65 percent from the latter. These taxes, not currently levied in Illinois, are considered to be the fairest of all taxes. One reason for the relatively lighter emphasis upon State sales and use taxes in the country as a whole is undoubtedly because many states derive a significant proportion of their revenues from income taxes.

In the case of taxes on motor fuels and tobacco products (cigarette taxes only in Illinois) the percentages for Illinois are slightly below the nation-wide average. They are higher in the case of taxes on alcoholic beverages, insurance, and pari-mutuel betting, but not by a wide margin. In the case of gross receipts taxes on public utilities and motor vehicle license fees, the percentages are definitely larger in Illinois than they are for all states combined.

TABLE 5

Percentage Distribution of Revenue From State Taxes And Licenses in Illinois and In All States, 1961

SOURCE	Illinois Percent	All States Percent
Sales and Gross Receipts		
Sales and Use Tax	43.91	23.61
Motor Fuels	16.73	18.00
Alcoholic Beverages	4.65	3.61
Tobacco Products	4.93	5.25
Insurance	3.32	3.07
Public Utilities	5.74	2.10
Pari-Mutuel	2.00	1.45
Amusement	.06	.10
Other	—	.64
Licenses		
Motor Vehicles	11.67	7.96
Motor Vehicle Operators	.75	.65
Corporations in General	.86	2.34
Public Utilities	.03	.13
Alcoholic Beverages	.14	.45
Amusements	.05	.03
Occupations and Businesses	.81	1.55
Hunting and Fishing	.38	.62
Other	.02	.04
Property	.12	3.31
Inheritance	3.83	2.63
Individual Income	—	12.36
Corporation Net Income	—	6.65
Severance	—	2.37
Poll	—	.04
Document and Stock Transfer	—	.60
Other	—	.39
	100.00	100.00

SOURCE: Derived from *State Government Finances in 1961*, Bureau of the Census.

CHAPTER XII

GENERAL PROPERTY TAX

By H. K. Allen*

The Revenue Article of the Constitution of Illinois provides that, "The General Assembly shall provide such revenues as may be needed by levying a tax, by valuation, so that every person and corporation shall pay a tax in proportion to the value of his, her or its property—such value to be ascertained by some person or persons to be elected or appointed in such manner as the General Assembly shall direct, and not otherwise."[1] A similar clause requires uniformity with respect to taxes levied by local governmental units.[2]

Except for specific categories which the General Assembly is authorized to exempt by general law, all real estate and all tangible and intangible property are subject to taxation under the general property tax. The exempted categories consist of most of the property of the State, counties and other municipal corporations both real and personal, and such other property as is used exclusively for agricultural and horticultural societies, and for school, religious, cemetery and charitable purposes.

TABLE 1

Total Property Taxes Extended in Illinois (000 omitted)

1961	$1,415,251*	1954	$ 790,541
1960	1,300,835	1953	740,441
1959	1,206,736	1952	708,161
1958	1,118,571	1951	647,059
1957	1,028,011	1950	593,069
1956	916,912	1949	566,542
1955	845,472	1948	535,395

SOURCE: Property Tax Division, Illinois Department of Revenue.
*Estimated.

Except for the tax on the gross receipts of the charter lines of the Illinois Central Railroad, the State Government derived all of its tax revenues from the general property tax until almost the beginning of the present century. With the levy of new State taxes during the first third of the present century, revenues from the State property tax dwindled in importance. The State Government made its last property tax levy in 1932. After the abandonment of the general property tax for State purposes, this

*The author is indebted to Eugene L. Maynard and Allan E. Garber, Property Tax Division, Department of Revenue, for constructive criticism of this report.
[1] Art. IX, Sec. 1.
[2] Art. IX, Sec. 10.

tax continued to be the principal source of revenue of the local governmental units of Illinois. More than 80 percent of all local tax revenues in Illinois are currently derived from the property tax. In fact, the property tax is by far the most important single source of revenue of State and local governments in Illinois. Table 1 shows the volume and trend of total property taxes extended from 1948 to 1961.

Total property tax extensions increased from $535,395,000 in 1948 to an estimated $1,415,251,000 in 1961, or 164 percent. Total property tax extensions for the various types of tax-levying jurisdiction are presented in Table 2.

It will be noted that extensions for school districts in 1960 amounted to more than half of total extensions.

Table 3 shows the total equalized assessed valuation of all taxable property in Illinois for the years 1948 to 1961.

The total equalized assessed valuation of all taxable property in Illinois increased from $22,386,013,000 in 1948 to $34,857,585,000 in 1961, or 56 percent. It will be noted that the increase in equalized assessed valuation (56 percent) lagged far behind the increase in property tax extensions (164 percent). Herein lies much of the explanation to the strong opposition that has developed among the citizens in recent years to further increases in property taxes. The lag is attributable in part to the fact that the State standard for computing county equalization factors was lowered between 1948 to 1961. Part of the gap, however, arises from the fact that additions

TABLE 2

Property Tax Extensions by Types of District: 1960

		Percent
County	$ 95,494,472	7.4
Township and Road Districts	62,249,847	4.8
Cities, Villages and Incorporated Towns	268,302,777	20.6
School Districts	736,615,388	56.6
Special Districts:		
Sanitary	61,489,721	4.7
Park	52,924,189	4.1
Fire	6,504,473	0.5
Airport	2,320,686	0.2
Forest Preserve	8,280,288	0.6
T. B. Sanitarium	2,478,112	0.2
Mosquito Abatement	1,095,044	0.1
Hospital	1,815,039	0.1
Miscellaneous Districts	1,265,130	0.1
Total	$1,300,835,166	100.0

to the tax base in the form of new construction, improvements, and higher property values have not kept pace with the increased property tax levies. Also, the amount of exempted property has been increased.

In view of the fact that equalized assessed valuations did not keep pace with property tax extensions, it is not surprising that average property tax rates steadily increased between 1948 to 1960. The figures are shown in Table 4.

Average property tax rates per one hundred dollars of equalized assessed valuation increased from 2.39 in 1948 to 3.79 in 1960.

Assessment Machinery. The State Department of Revenue assesses the "operating property" of railroads (in accordance with the "unit rule" method) and the "operating personal property" of private car lines doing business in Illinois. The Department of Revenue also assesses the capital stock (corporate excess), including the franchise, of all corporations incorporated in the State, except specific classes which fall under the jurisdiction of local assessors. All other property in the 102 counties in Illinois is assessed locally.

TABLE 3

Total Equalized Assessed Valuation of Property (000 omitted)

1961	$34,857,585	1954	$26,134,106
1960	34,322,727	1953	25,529,338
1959	33,683,409	1952	25,283,003
1958	32,006,431	1951	24,826,204
1957	31,263,639	1950	23,133,088
1956	28,608,587	1949	22,738,463
1955	27,603,250	1948	22,386,013

SOURCE: Property Tax Division, Illinois Department of Revenue.

TABLE 4

Average Property Tax Rates Per One Hundred Dollars Of Equalized Assessed Valuations: 1960

1960	3.79	1953	2.90
1959	3.58	1952	2.80
1958	3.49	1951	2.61
1957	3.29	1950	2.56
1956	3.20	1949	2.49
1955	3.06	1948	2.39
1954	3.02		

SOURCE: Property Tax Division, Illinois Department of Revenue.

In the 17 counties which have the commission form of government property is assessed by the County treasurer as ex officio county assessor or by an appointed county assessor. In the 85 counties which have the township type of organization, except Cook and St. Clair, local assessments are made by elected township assessors under the supervision of the county treasurer as ex officio supervisor of assessments, or an appointed supervisor of assessments. St. Clair County has elected township assessors and an elected board of assessors composed of five members. Cook County has an elected county assessor and elected township deputy assessors in townships outside the City of Chicago. Personal property is assessed as of April 1 and realty as of January 1.

General Property Tax Unsound In Theory. In view of the fact that the general property tax has broken down in all the states and has been abandoned in most states, it seems appropriate to examine the theoretical soundness of the tax. If a tax is unsound in principle, serious difficulties will inevitably be encountered in its administration. The general property tax is based upon the assumption that the value of property, regardless of its nature, is a proper basis for determining the amount of property taxes that should be paid. It assumes, moreover, that a given amount of property of one type represents the same capacity to pay taxes as the same amount of any other type.

The theory of the general property tax was reasonably sound when Illinois was a predominantly agricultural economy, but it became discredited to a large extent when the State became industrialized. When it was a rural, agricultural economy, the property of each individual consisted of similar items—land, buildings, livestock, and farm implements—forms of wealth which could not be easily concealed from the assessor and which could be fairly accurately evaluated for purposes of taxation.

As the economy developed industrially and commercially, new and markedly different forms of property came into being such as stocks, bonds, mortgages, and other types of intangibles. Although the owner usually receives income from intangibles, it is not always the case and, in any event, income from various types of intangibles varies widely relative to value. Intangibles, moreover, are often owned by persons who live outside the taxing jurisdiction in which the real wealth upon which the "paper claims" are based is located. In these situations the owners derive no personal benefits from the locality in which the "basic property" is located. For these reasons, the taxation of intangibles at the same (uniform) rate that applies to real estate and some other types of tangible property cannot be justified. In fact, any attempt to do so would in many cases result in confiscation of the income derived from the intangibles.

Industrialization of Illinois has also been accompanied by a marked expansion in the service trades and in professional services of various types, many of which yield lucrative incomes. These individuals pay property

taxes directly or indirectly, but the ratios of property tax payments to incomes vary widely among various individuals.

The following statement by Seligman in 1913 traces the development of the general property tax:

> "History thus everywhere teaches the same lesson. As soon as the idea of direct taxation has forced itself into recognition, it assumes the practical shape of the land tax. This soon developes into the general property tax which long remains the index of ability to pay. But as soon as the mass of property splits up, the property tax becomes an anachronism. The various kinds of personalty escape, until finally the general property tax completes the cycle of its development and reverts to its original form of the real property tax. The property tax in the United States is simply one instance of this universal tendency; it is not an American invention, but a relic of mediaevalism. In substance though not in name, it has gone through every phase of the development, and any attempt to escape the shocking evils of the present by making it a general property tax in fact as well as in name is foredoomed to failure. The general property tax as the chief source of revenue is impossible in any complicated social organism. Mediaeval methods cannot succeed amid modern facts."[3]

The theory of the general property tax is also defective when consideration is given to tax shifting. Taxes on purely personal property, including owner-occupied homes, cannot be shifted. On the other hand, a tax on agricultural property, except on the value of unimproved land, and on other real and tangible property used in business pursuits is a cost of production and hence shiftable, at least in part, to consumers. Taxes on rented property are shiftable and are thus borne largely by tenants in the long run. Owners of stocks, bonds, mortgages, and other intangibles, however, cannot shift property taxes on such items.

To the extent that any unshifted portions of a property tax on real estate results in a lower rate of return after taxes than could be obtained from alternative investments, the possibility exists that subsequent purchasers take into account (capitalize) the excess by paying a lower price for such real estate than they would otherwise be willing to pay. In this event, the burden of the excess tax remains upon the individuals who owned the real estate at the time the tax levies which caused the excess were adopted. Subsequent purchasers buy the real estate free of the excess tax. No such possibility exists, however, in the case of real estate and numerous types of personal property that are not sold. Prices of most intangibles, moreover, are determined in nation-wide or even world-wide markets, and the property tax on such items cannot be capitalized. Their values are affected little, if any, by the amount of property tax levied against them in a particular state.

The serious defects in the theory of the general property tax have been a major cause of the breakdown in its administration. In his classic indict-

[3]E. R. A. Seligman, *Essays in Taxation*, Tenth Edition, The Macmillan Company, 1925, p. 56.

ment of the administration of the general property tax, made almost 50 years ago, Seligman commented as follows:

> "Practically, the general property tax as actually administered is beyond all doubt one of the worst taxes known in the civilized world. Because of its attempt to tax intangible as well as tangible things, it sins against the cardinal rules of uniformity, of equality and universality of taxation. It puts a premium on dishonesty and debauches the public conscience; it reduces deception to a system, and makes a science of knavery; it presses hardest on those least able to pay; it imposes double taxation on one man and grants entire immunity to the next. In short, the general property tax is so flagrantly inequitable, that its retention can be explained only through ignorance or inertia. It is the cause of such crying injustice that its alteration or its abolition must become the battle cry of every statesman and reformer."[4]

Seligman's statement is a suitable preface for an analysis of the administration of the general property tax in Illinois.

Real Estate Assessments

One of the major defects in the administration of the general property tax is the inequitable distribution of the tax burden between real estate and personal property. It is estimated that at least half of the total wealth of Illinois consists of tangible and intangible personal property yet the percentage distribution of property tax assessments in 1961 was as follows:[5]

Lands	Lots	Personalty	Railroads	Total
18%	59%	20%	3%	100%

Whereas personal property constitutes at least 50 percent of the total value of all property in the State, personal property assessments in 1961 represented only 20 percent of total property tax assessments. This discrimination results from the fact that much personal property, especially intangibles, escapes assessment entirely or is assessed at a lower percentage of full value than real estate.

One of the major problems of taxation in Illinois is to find and adopt an effective method of reaching the capacity to pay taxes that attaches to the ownership of personal property. Closely related to this problem is the attainment of greater uniformity in the assessment of real estate.

Some improvement has been made in the assessment of lands and lots, including houses, during the last 15 years, but gross inequalities still exist in the assessment of these classes of property. This fact is evidenced by statistics compiled by the Department of Revenue. Statistics pertaining to real estate assessment medians, coefficients of dispersion, and range of assessments in 1958 are presented in Table 5.

Although the assessment of property at full value has been a statutory requirement since 1927, it will be noted that the level of both urban and rural assessments is far below full value. Before equalization, the median

[4] *Ibid.*, p. 62.
[5] Property Tax Division, Department of Revenue.

assessment ratio of urban property in 1958 varied from 57 percent in Edwards County to 7 percent in Tazewell County. In the case of rural property, the median varied from 57 percent in Union County to 8 percent in Saline and Sangamon Counties.

Equalization among counties by the Department of Revenue is intended to place the general level of assessments in all counties on a uniform basis, but State equalization does not correct inequalities in original assessments within county boundaries. Any disparity in the original assessment of two houses is not corrected by application of the same multiplier to both assessments. State equalization reduces inequalities only as among counties and with respect to county-wide assessment ratios.

TABLE 5

Assessment Medians, Coefficients of Dispersion, and Assessment Ranges, For All Counties 1958

County	Median	Coefficient of Dispersion	Range
ADAMS			
Rural	18	20	22
Urban	11	22	31
ALEXANDER			
Rural	12	44	15
Urban	18	31	22
BOND			
Rural	45	16	82
Urban	41	16	140
BOONE			
Rural	44	22	38
Urban	49	14	108
BROWN			
Rural	20	15	13
Urban	17	27	22
BUREAU			
Rural	50	14	36
Urban	52	12	85
CALHOUN			
Rural	—	—	—
Urban	—	—	—
CARROLL			
Rural	42	13	26
Urban	44	16	58

TABLE 5 (Continued)

County	Median	Coefficient of Dispersion	Range
CASS			
Rural	—	—	—
Urban	38	20	183
CHAMPAIGN			
Rural	43	16	36
Urban	47	13	53
CHRISTIAN			
Rural	46	17	37
Urban	43	27	144
CLARK			
Rural	44	19	58
Urban	41	22	69
CLAY			
Rural	44	26	101
Urban	38	22	65
CLINTON			
Rural	13	27	13
Urban	11	28	16
COLES			
Rural	48	21	49
Urban	46	13	96
COOK			
Chicago	24	18	119
County	25	22	119
Townships	24	14	97
CRAWFORD			
Rural	47	21	51
Urban	43	16	113
CUMBERLAND			
Rural	34	28	37
Urban	35	27	51
DE KALB			
Rural	42	11	27
Urban	43	18	70
DE WITT			
Rural	39	18	38
Urban	44	20	103
DOUGLAS			
Rural	45	12	94
Urban	38	14	139

TABLE 5 (Continued)

County	Median	Coefficient of Dispersion	Range
DU PAGE			
Rural	—	—	—
Urban	53	10	116
EDGAR			
Rural	42	17	45
Urban	43	22	147
EDWARDS			
Rural	—	—	—
Urban	57	13	51
EFFINGHAM			
Rural	9	32	13
Urban	11	27	32
FAYETTE			
Rural	40	29	70
Urban	41	22	88
FORD			
Rural	—	—	—
Urban	44	14	38
FRANKLIN			
Rural	42	15	42
Urban	38	20	62
FULTON			
Rural	51	16	39
Urban	52	18	66
GALLATIN			
Rural	—	—	—
Urban	9	28	13
GREENE			
Rural	48	21	46
Urban	41	23	98
GRUNDY			
Rural	—	—	—
Urban	39	17	52
HAMILTON			
Rural	39	19	38
Urban	44	18	34
HANCOCK			
Rural	51	15	34
Urban	48	19	60

TABLE 5 (Continued)

County	Median	Coefficient of Dispersion	Range
HARDIN			
Rural	—	—	—
Urban	42	23	37
HENDERSON			
Rural	—	—	—
Urban	38	25	62
HENRY			
Rural	46	12	39
Urban	37	19	59
IROQUOIS			
Rural	12	20	57
Urban	9	32	60
JACKSON			
Rural	10	24	11
Urban	8	25	15
JASPER			
Rural	40	17	51
Urban	37	26	82
JEFFERSON			
Rural	44	22	52
Urban	47	16	87
JERSEY			
Rural	16	15	16
Urban	10	30	20
JO DAVIESS			
Rural	51	13	73
Urban	44	19	80
JOHNSON			
Rural	16	19	15
Urban	14	17	14
KANE			
Rural	44	16	44
Urban	46	12	260
KANKAKEE			
Rural	49	12	28
Urban	50	9	194
KENDALL			
Rural	42	15	32
Urban	39	17	57

TABLE 5 (Continued)

County	Median	Coefficient of Dispersion	Range
KNOX			
Rural	49	11	48
Urban	54	11	111
LAKE			
Rural	43	24	61
Urban	50	14	172
LA SALLE			
Rural	51	10	42
Urban	46	15	66
LAWRENCE			
Rural	39	23	40
Urban	40	19	42
LEE			
Rural	38	27	58
Urban	39	19	64
LIVINGSTON			
Rural	45	20	51
Urban	49	14	146
LOGAN			
Rural	45	8	44
Urban	36	23	90
MC DONOUGH			
Rural	48	15	62
Urban	48	16	65
MC HENRY			
Rural	48	18	41
Urban	54	14	82
MC LEAN			
Rural	47	12	34
Urban	52	11	64
MACON			
Rural	44	11	27
Urban	42	16	394
MACOUPIN			
Rural	45	16	50
Urban	43	23	80
MADISON			
Rural	48	20	39
Urban	53	13	121

TABLE 5 (Continued)

County	Median	Coefficient of Dispersion	Range
MARION			
Rural	46	12	58
Urban	52	14	98
MARSHALL			
Rural	—	—	—
Urban	22	18	22
MASON			
Rural	35	26	44
Urban	36	18	49
MASSAC			
Rural	—	—	—
Urban	11	31	23
MENARD			
Rural	16	16	13
Urban	18	25	26
MERCER			
Rural	49	19	48
Urban	38	25	76
MONROE			
Rural	19	26	24
Urban	19	13	28
MONTGOMERY			
Rural	44	20	41
Urban	42	23	60
MORGAN			
Rural	42	15	35
Urban	39	15	78
MOULTRIE			
Rural	—	—	—
Urban	37	24	—
OGLE			
Rural	47	16	37
Urban	43	17	61
PEORIA			
Rural	43	14	42
Urban	46	17	167
PERRY			
Rural	45	17	122
Urban	34	27	76

TABLE 5 (Continued)

County	Median	Coefficient of Dispersion	Range
PIATT			
Rural	44	14	22
Urban	52	14	55
PIKE			
Rural	23	13	50
Urban	22	21	33
POPE			
Rural	48	26	41
Urban	46	12	35
PULASKI			
Rural	36	29	39
Urban	37	22	40
PUTNAM			
Rural	—	—	—
Urban	—	—	—
RANDOLPH			
Rural	42	21	50
Urban	42	20	100
RICHLAND			
Rural	47	14	33
Urban	56	14	147
ROCK ISLAND			
Rural	44	20	40
Urban	42	13	70
ST. CLAIR			
Rural	33	26	34
Urban	40	16	75
SALINE			
Rural	8	25	12
Urban	8	26	23
SANGAMON			
Rural	8	25	10
Urban	8	25	25
SCHUYLER			
Rural	14	18	14
Urban	11	26	12
SCOTT			
Rural	18	26	19
Urban	15	33	22

TABLE 5 (Continued)

County	Median	Coefficient of Dispersion	Range
SHELBY			
Rural	34	21	51
Urban	37	18	61
STARK			
Rural	29	7	45
Urban	36	12	64
STEPHENSON			
Rural	39	12	32
Urban	43	14	93
TAZEWELL			
Rural	9	27	27
Urban	7	20	68
UNION			
Rural	57	17	122
Urban	48	15	53
VERMILION			
Rural	44	10	46
Urban	46	17	81
WABASH			
Rural	36	14	25
Urban	38	19	44
WARREN			
Rural	47	14	57
Urban	49	18	56
WASHINGTON			
Rural	49	14	44
Urban	50	10	60
WAYNE			
Rural	45	19	92
Urban	39	18	67
WHITE			
Rural	43	23	40
Urban	44	22	75
WHITESIDE			
Rural	47	19	31
Urban	47	18	70
WILL			
Rural	45	15	29
Urban	46	14	57

TABLE 5 (Continued)

County	Median	Coefficient of Dispersion	Range
WILLIAMSON			
Rural	9	33	20
Urban	8	25	15
WINNEBAGO			
Rural	42	25	34
Urban	53	9	85
WOODFORD			
Rural	44	11	21
Urban	46	13	43

SOURCE: Property Tax Division, Department of Revenue.

Inequalities in original assessments within the various counties is indicated to some extent by the figures on the range of assessments. These figures show the number of percentage points between the lowest and the highest assessment ratio of individual parcels of urban and rural property in each county. If all parcels of urban or rural property in a county were assessed at precisely the same percentage of full value, the assessment range for the particular class of property would be zero.

The quality of property tax assessments can also be tested by computing deviations from the average. Coefficients of dispersion (Table 5) for rural parcels of real estate range from 44 in Alexander County to 7 in Stark County. The highest for urban property is 33 in Scott County; the lowest is 9 in Kankakee and Winnebago Counties. Relative to coefficients of dispersion, Professor H. M. Groves states that, "A margin of tolerance of 10 percent may be allowed for imperfections in the data; a coefficient above this figure is cause for concern."[6] According to Groves' standard, "cause for concern" relative to the quality of real estate assessments exists in all Illinois counties except four. Stark County had a coefficient of 7 for both rural and urban property. Logan had a coefficient of 8 for rural property. Both Kankakee and Winnebago Counties had coefficients of 9 for urban property. It is gratifying to report that 31 counties had coefficients of 15 or less for urban property. These coefficients, it should be noted are based on sales ratios of relatively small samples, and may be higher or lower than would be the case if they were based on all parcels of real state in the county.

Statistics are not available to test the quality of assessments of public utility companies and large industrial and commercial concerns. Properties of these concerns are seldom sold and they are thus seldom included in the sales ratio studies made by the Department of Revenue. It is obvious, however, that local assessors do not possess the technical knowledge that is es-

[6] *Financing Government*, Fifth Edition, Henry Holt and Company, New York, 1958, pp. 71-72.

sential for the accurate assessment of such types of property. Public utility property is a case in point. Under existing law, local assessors are required to assess underground telephone and telegraph cable and conduits; wire and overhead cables; poles, towers, and fixtures; transformers and equipment; power generating stations and equipment; converting and substation equipment; switch boards; oil and gas pipes and mains; storage tanks; and pumping stations. The difficulty of making accurate assessments of such types of property, even with the aid of the Department of Revenue, is readily apparent.

County Supervisor of Assessments. In accordance with a recommendation of the 1947 Revenue Laws Commission, the General Asesmbly in 1949[7] authorized the establishment of a full-time, appointive, county assessment supervisor in each county of the state except Cook and St. Clair.[8] This officer was vested with responsibility for all real estate and personal property assessments made by the local assessors. The law provided that the county assessment supervisor should be appointed by the county board from a list of candidates certified by the Department of Revenue as to their experience and qualifications for the position. Elective township assessors were retained, but the statute provided that they were to serve as ex officio deputy assessors under the county assessment supervisor. Under this law, the county assessment supervisor had authority annually to revise assessments and to correct the same as such revision appeared to him to be justified. The assessment of property was made a continuous year-round function and provision was made for the use of tax maps, property record cards, and other assessment aids.

Although the original county assessment supervisor law was one of the most progressive measures ever adopted in the area of property tax administration in Illinois, it had been in effect only a short while when its constitutionality was contested. In the case of *Giebelhausen* v. *Daley*[9] the Supreme Court of Illinois held that the county assessment supervisor law was unconstitutional on the ground, among other reasons, that the certification of qualified candidates by the Department of Revenue was an unconstitutional encroachment of state authority upon local affairs.

A new county supervisor of assessments law was adopted in 1953 to take the place of the one that had been declared unconstitutional.[10] Unfortunately, the new law was a much weaker measure than its predecessor. It does not provide for examination or certification of candidates for the office by the Department of Revenue. Even more important, it omitted the provision in the original law whereby township assessors were made ex officio deputy assessors under the county supervisor of assessments. The new law authorizes the county supervisor of assessments to assemble all assessors

[7] *Report of the Revenue Laws Commission*, 1949, Part I, pp. 13-14.
[8] *Laws of Illinois*, 1949, p. 1274.
[9] 407 Illinois 25 (1950).
[10] *Laws of Illinois*, p. 1602.

and their deputies for consultation and to give such instructions to them as will tend to a uniformity in their actions. Unlike the original measure, it does not give the county supervisor of assessments authority to revise and correct individual real estate assessments annually. The present statute limits such changes to the quadrennial year. Some county supervisors of assessment think that they have authority to make changes annually and do make such changes. The county supervisor of assessments is in fact more of an advisor than he is a supervisor or director. Some 30 to 35 counties have appointed supervisors of assessment under the 1953 law and, considering the restricted authority under which they operate, some of them are making good progress in improving the assessment of some classes of property.

Suggested Changes in Assessment Machinery. The following changes, the writer believes, would greatly improve the quality of property tax assessments:

1. Jurisdiction of the assessment of property of public utility companies should be vested in a state agency.[11]
2. Large industrial and commercial properties should be assessed by a state agency. This objective might best be implemented by transferring jurisdiction of assessment of property of all incorporated enterprises to the state agency.
3. Township assessors should be abolished and their powers and duties should be assigned to an appointive county supervisor of assessments; or township assessors should be made ex officio deputy assessors and assigned to work under the direction of the county supervisor of assessments. If the latter plan should be adopted, it is assumed that the assessment activity of township assessors would be limited to personal property of individuals and unincorporated businesses as is now the practice in Cook County.
4. The authority of the county supervisor of assessments to revise individual assessments annually as under the 1949 law should be restored. The county assessment supervisor should be the chief assessment officer with full responsibility for assessments at the local level. The term of the county assessment supervisor should be increased from four to six years as is presently the case in the office of county superintendent of highways.
5. Since the objective of strengthening the office of county supervisor of assessments is to achieve correct original assessments, it is suggested that the functions of boards of review be limited to action upon complaints. Equalization among various districts of the county should be the responsibility of the county supervisor of assessments. Boards of review are not equipped to perform the equalization function effectively, and they cannot eliminate the gross inequalities that

[11] The appropriate state agency to handle this and other assessment functions would be a new 7State Board of Equilization and Assessment, details of which are explained in the chapter on State Equalization of Local Assessments.

exist in original assessments. If assessments are not made correctly in the first instance, boards of review can do little to improve them. If the original assessments are made correctly then boards of review can limit their activities to the proper function of considering complaints.

6. In counties which have a serious lack of uniformity in assessments as measured by assessment range, coefficient of dispersion, etc., careful consideration should be given to the employment of commercial appraisers to evaluate every parcel of real estate in the county. Such an appraisal would provide an excellent basis for the attainment of uniform assessments in future years.
7. With the establishment of assessment activities on a continuous, year-round basis under a competent county supervisor of assessments, it should be possible to reduce the lapse of time that exists under the present law between the effective assessment date (January 1 for real estate and April 1 for personal property) and the delinquency date for the first installment of real estate taxes (June 1 of the following year). After the plan proposed herein has been in effect for three or four years, it should be possible to use July 1 as the effective assessment date for both realty and personalty.

Assessment of Tangible Personal Property

A detailed discussion of personal property taxes can perhaps best be undertaken in the light of knowledge as to the relative importance of the various categories. Table 6 shows the equalized assessed valuations of specific categories of personal property for 1961. It should be kept in mind that personal property assessments represent about 20 percent of total property assessments. Some of the categories of personalty, as will be explained later, are more significant with reference to the amount that escapes assessment than they are with respect to the amount assessed.

Among the various categories of tangible personalty, machinery and equipment is largest with 28.2 percent of the total equalized, assessed valuation of personal property; merchandise, consisting of goods on hand and in process, is second with 16.9 percent; passenger cars and trucks rank third in importance, with 14.4 percent of the total.

Public utility personalty (listed in Table 6) represented 7.7 percent of total equalized assessed valuation of personal property. This item consists of machinery, equipment, tools, supplies, pipe lines, electric and telephone lines, and certain other types of tangible personal property. It will be noted that Cook County reported no assessment of this class of property. In Cook County and in some other counties the assessments of public utility personalty are included in other categories such as machinery and equipment and office and store furniture.

Household furniture and equipment amounts to only 5.6 percent of the total, and cattle, swine, poultry, and other livestock account for only

3.0 percent of the total. Office and store furniture represent 2.7 percent of the total. Grain and hay and personal effects account for 1.2 percent and 0.4 percent, respectively.

Machinery and Equipment, Merchandise, and Public Utility Personalty. Facts are not available to test the accuracy and completeness of the assessment of machinery and equipment and merchandise. It is a certainty, however, that most local assessors do not possess the technical knowledge required to assess complex types of machinery and equipment. It is a safe assumption that there are gross inequalities in the assessments of these types of property. The requirement that merchandise (goods on hand and in process) be assessed as of April 1, operates unfairly at between firms that have high inventories on the effective assessment date and those that have low inventories. Because of the large amount of revenue involved, exemption of machinery, equipment, and merchandise cannot be afforded.

TABLE 6

Equalized Assessed Valuations of Specific Classes of Personal Property: 1960*

	Cook County	Downstate	Entire State	Percent
Passenger Cars ....$	63,899,536	$ 735,379,142	$ 799,278,678	11.5
Trucks, Buses, and Trailers	73,046,743	124,634,300	197,681.043	2.9
Cattle	168,722	175,634,300	175,519,794	2.6
Swine	13,367	30,110,670	30,124,037	0.4
Other Livestock and Poultry	74,229	6,403,607	6,477,836	0.1
Grain, Hay, etc.	870,996	80,567,940	81,438,936	1.2
Household Furniture	24,593,023	354,869,557	379,452,580	5.6
Office and Store Furniture	124,040,994	61,159,063	185,200,057	2.7
Personal Effects	10,020,279	15,922,713	25,942,992	0.4
Machinery and Equipment.	1,147,975,408	764,357,572	1,912,332,990	28.2
Merchandise, Goods on Hand and in Process ...	732,439,339	414,339,491	1,146,778,830	16.9
Money—Cash and Bank Deposits	10,099,415	15,555,874	25,655,289	0.4
Net Credits	6,639,955	6,112,154	12,752,109	0.2
Taxable Stocks and Bonds.	100,918,192	12,068,486	112,986,678	1.7
All Other Personal Property	12,138,335	57,357,860	69,496,195	1.0
Capital Stock† (Domestic)	323,660,998	339,429,826	663,090,824	9.8
Shares of Bank Stock	81,846,231	105,689,899	187,536,130	2.8
Net Receipts—Fire Insurance	10,349,825	23,119,360	33,469,185	0.5
Public Utility Personalty ..		521,487,801	521,487.801	7.7
Penalties	196,745,188	7,868,105	204,613,293	3.0
TOTAL ....$	2,919,540,775	$3,851,784,492	$6,771,325,267	100.0

SOURCE: Property Tax Division, Department of Revenue.
*Excludes personal property of railroads and oil and coal leases.
†Includes $9,390,800 assessment on private car lines.

The challenge is to improve the assessment of these classes of personalty to the fullest possible extent.

The situation as to the assessment of public utility personalty is similar to that of machinery and equipment. Most local assessors are not competent to assess the various forms of public utility personalty. In fact, the task would challenge even the technical specialist. Revenue considerations, however, do not permit the exemption of this type of property. It should be assessed in conjunction with public utility realty by a state agency.

Assessment of Motor Vehicles. With the exception of Cook County, a better job is probably done in the assessment of motor vehicles than is true in the case of any other category of tangible personalty. The primary reason for this success is that the Secretary of State supplies local assessment officials with information pertaining to registrations. Moreover, standard valuation figures employed by used car dealers are available and widely used by assessors. This class of personal property is one of the few types of personalty that is well adapted to assessment by local assessors.

Table 7 contains facts pertaining to the assessment of passenger automobiles in a selected group of counties in 1961. The percentages of the number assessed to the number registered range from 13 percent in Cook County to 95 percent in Alexander County. Most of them, it will be noted, range in the neighborhood of 80 percent. It is not presumed that the number assessed should be the same as the number registered, because assessments are based on April 1, while ownership and registrations are for the entire calendar year. Also, some motor vehicles are tax exempt; moreover, tax situs and registration situs are different in some cases.

Apparently, no serious effort is made to assess passenger cars in Cook County. This situation stems in part from the fact that the City of Chicago levies a fairly high wheel tax, and the citizens strongly object to paying both the wheel tax and a personal property tax. It should be interjected here that many downstate cities also levy wheel taxes. Since wheel tax revenues go exclusively to the city, the other local jurisdictions do not share in such revenues and they do obviously lose property tax revenues from passenger cars that are not assessed. The assessment of trucks in Cook County is more efficient, the percentage assessed to the number registered being 44 percent.

In 33 of the 35 counties listed in the table, average equalized assessed valuations ranged between $350 and $600. Lake County is the lowest in the list with $268 and Woodford County is highest with $584.

Notwithstanding the superiority of motor vehicle assessments over other categories of personal property, there is still room for improvement. Admittedly, the problem is especially difficult in counties that have a large number of students, military personnel, or other persons who have a short period of residence in the county. In most counties, nevertheless, the assessment of this class of property could be improved.

The plan used in Indiana is worthy of consideration. In applying for a state license in Indiana an owner of a motor vehicle is required to present evidence that the personal property tax on the vehicle has been paid. Another possibility would be to give the appropriate county official or board authority to assess motor vehicles from registration information supplied by the Secretary of State.

A different approach would be to exempt motor vehicles completely from the property tax, thereby allowing local units, cities and villages in particular, to expand the use of wheel taxes. The difficulty with this proposal, as suggested above, is that it would result in a loss of revenue to all local units that did not make offsetting wheel tax levies. For all local units to levy wheel taxes would, of course, be highly objectionable. All motor vehicles combined represented 14.4 percent of total personalty assessments and about 2.9 percent of total property assessments in 1960. The amount of property tax revenue derived from this category of property, calculated in terms of the state-wide average property tax rate was about $37,000,000 in 1960. Because of the quality of the assessments and the amount of revenue involved, it would be unwise to exempt motor vehicles from the property tax.

Household Furniture and Personal Effects. For thousands of individuals in Illinois who are not engaged in business or farming, their personal property tax assessments consists exclusively of household furniture and automobiles. The assessment of the former, however, is far inferior to that of the latter.

In the case of many local assessors, household furniture is assessed on the "same as last year" basis, that is, the figure for the preceding year is used for the current assessment. Regardless of age or quality, some assessors use a specific nominal amount per room in making the assessment. Others "refine" this method by separate listings with nominal amounts for such items as automatic washers and dryers, pianos, electric refrigerators, deep freezers, radios, and television receiving sets. In a few instances, a specific percentage of the assessed valuation of the house is used in assessing household furniture. In the City of Chicago, assessors are instructed that ordinary household furniture should be considered as having no value for property tax purposes.

Statistics are not available to prove the point, but it appears probable that the method of assessing household furniture results in discrimination against lower income families as compared with wealthier families. Because of the serious defects in the assessment of this class of personalty, a strong case can be made for its exemption. It is doubtful whether any method is available whereby household furniture could be assessed in a complete and equitable manner. For the State as a whole, the loss of revenue that would result from exempting household furniture would amount to about 5.6 percent of total personal property tax collections, or about 1.1 percent of total property tax revenues. The revenue involved estimated on the basis of the

TABLE 7

Assessment of Passenger Automobiles in Selected Counties, 1961

Counties	Number Assessed	Number Registered	Percent Assessed	Average Equalized Value
Alexander	4,038	4,248	95	$425
Boone	6,952	8,067	86	559
Calhoun	1,590	1,992	80	583
Cass	4.525	5.564	81	523
Champaign	33,400	44,761	75	475
Christian	10,849	13,884	78	487
Cook	199.906	1,552,414	13	394
Cumberland	2,742	3,539	77	497
DeKalb	16,594	20,065	83	555
DeWitt	5,708	6,662	86	469
Edgar	6,647	8,459	79	530
Edwards	2,769	2,992	93	400
Franklin	10,457	14,300	73	457
Hancock	7,306	9,257	79	312
Hardin	1,584	1,892	84	554
Jo Daviess	6,232	7,589	82	471
Kankakee	26,364	30,476	87	384
Lake	82,889	110,480	75	268
LaSalle	34,756	40,704	85	498
Lawrence	5,535	7,122	78	494
Madison	61,205	81,610	75	443
Marion	12,962	15,023	86	475
McLean	27,752	31,790	87	547
Mercer	4,945	6,455	77	399
Ogle	12,216	15,634	78	473
Randolph	7,901	9,822	80	401
St. Clair	57,049	86,657	66	339
Saline	7,620	8,784	87	497
Sangamon	50,629	56,574	89	371
Scott	2,105	2,434	86	551
Stark	2,629	3,161	83	524
Whiteside	18,379	23,235	79	483
Will	56,335	69,681	81	400
Winnebago	65.092	82,380	79	576
Woodford	7,549	9,154	82	584

SOURCE: Statistics on assessments are from the Property Tax Division of the Department of Revenue. Data on registrations were supplied by the Secretary of State. Federal and State owned vehicles and vehicles from other states are excluded from the tabulation.

state-wide average property tax rate, was about $14,000,000 in 1960. The exemption of this or any other category from the property tax would probably require a constitutional amendment.

Probably every citizen in Illinois is in violation of the law pertaining to the taxation of personal effects. Under the law, all clothing, jewelry, luggage and other personal effects are subject to taxation; there are no exemptions. In actual practice, the assessment of this class of property presents a farcical situation. The abstract of assessments for 1961 shows no assessment of personal effects in Hamilton, Livingston, and Menard Counties. Some of the counties which reported exceedingly low total equalized assessments of personal effects are Bond, $613; Brown, $250; Greene, $150; Johnson, $545; and Pope, $78. It should be emphasized that the figures cited are totals for the entire county in each instance. Even in counties that have much higher totals than those mentioned, the average per family is so low as to amount to only a token assessment. The facts relative to the gross inadequacy of the assessment of personal effects supports the view, held by many competent students of the subject, that this class of property should be exempted from the property tax. The revenue implications of such exemption are indicated by the fact that the assessments of personal effects account for 0.4 percent of total personalty assessments for the entire state and about 0.08 percent of total property assessments. In tax dollar terms, the amount in 1960 was about $1,000,000.

Livestock, Hay and Grain. Suggestions for the assessment of livestock, hay, and grain are given each year to assessors in a local meeting, but most of the assessors exercise wide discretion in carrying out the suggestions. The value of livestock, hay, and grain owned by a farmer varies widely throughout the year and the amount on hand on the effective assessment date (April 1) may be much below or above the average holdings for the year. Depending upon breeding, marketing, and other practices, a particular farmer may have large holdings of livestock, grain and hay on April 1 whereas another similarly situated farmer may have a small inventory of these items on the same date. Assessors know these facts and attempt to take them into account, but because of an absence of uniform standards the result is that the assessments are incomplete, inaccurate, and inequitable.

Alexander, Franklin, Hamilton, and Jersey Counties reported no assessments for grain and hay in 1961. Total amounts reported in Massac and Williamson Counties were $344 and $1,576, respectively.

That standards for the assessment of cattle and swine vary widely among the counties is evidenced by the statistics in Table 8 which show average equalized assessed valuations of these categories of livestock. The averages for cattle range from $22.44 in Alexander County to $135.14 in Clinton County. The comparable range for swine is from $4.94 in Pulaski County to $32.74 in Clinton County. This comparison is on an intercounty

basis, but it is doubtful whether the quality of the assessments within counties is significantly better.

It seems unlikely that any change in the administration of assessments would significantly improve the assessment of livestock, hay and grain. These categories of tangible personalty should be exempted from the property tax. The equalized assessed valuations of these classes of tangible personal property represent 4.3 percent of total personalty assessments or less than one percent of total property assessments. The revenue from these classes of property in 1960 amounted to about $10,800,000.

Office and Store Furniture. Facts are not available to test the adequacy of assessments of office and store furniture. On *a priori* grounds, however, it may logically be assumed that the assessment of this type of personalty is no better than that of most other categories of such property. In the opinion of the writer, the assessments are on a "hit" or "miss" basis with emphasis upon the latter. This category accounted for 2.7 percent of total personalty assessments and produced approximately $6,750,000 in 1960.

Administrative Costs. Several of the categories of tangible personal property discussed above do not, as pointed out, produce significant amounts of revenue. They are unlikely, moreover, to produce significant amounts of revenue in the future. Although features of the general property tax which in its entirety is a highly productive source of revenue, property taxes on these particular items are in effect nuisance taxes.

The low yield of the taxes under discussion raises the question of administrative costs. Information is not available as to the over-all cost of administering the property tax in Illinois, nor are facts available as to the administrative costs that are attributable to the personal property tax. To a

TABLE 8

Average Equalized Assessed Valuations of Cattle and Swine in Selected Illinois Counties, 1961

County	Cattle	Swine	County	Cattle	Swine
Alexander	$ 22.44	$ 8.29	Lake	$76.43	$10.56
Brown	103.69	24.53	McHenry	89.27	16.86
Clinton	135.14	32.74	Madison	63.85	15.55
Douglas	58.75	12.47	Mercer	53.39	9.91
Effingham	80.52	19.64	Peoria	43.81	8.40
Greene	53.43	11.96	Pulaski	27.74	4.94
Hancock	68.12	12.47	Sangamon	50.59	11.54
Henry	84.66	21.27	Stephenson	99.81	17.26
Jersey	38.29	14.11	Warren	67.67	13.16
Kane	87.34	25.12	Will	45.17	10.77

SOURCE: Property Tax Division, Department of Revenue.

large extent the two major components of the property tax are jointly administered and it is not possible to segregate costs as between real estate and personal property.

Although factual evidence is not available to support the conclusion it may reasonably be assumed that the personal property tax has a high cost of administration. The average amount of the individual personal property tax is small, yet if the assessment is properly made a personal visit by the assessor to each property owner is required. In any event, a great deal of paper work is required between the time that the schedule is filled out and the tax is collected. As previously mentioned, delinquency is a particularly troublesome problem in the case of personal taxes and the collection of delinquent personal taxes is costly. Obviously, the cost of administration of personal property taxes could be significantly reduced if the accuracy and completeness of the assessments were improved and if more vigorous methods of collection were employed.

Assessment of Specific Categories of Intangibles

In no other instance is the breakdown of the personal property tax in Illinois more clearly evident than it is in the case of intangibles. A large amount of income accrues to the owners of intangibles, but if they are assessed at all it is usually only at nominal amounts. Most intangibles are owned, moreover, by persons in the middle and higher income groups. The problem of reaching this class of property in a complete, fair, and equitable manner is the most important single problem in the administration of the personal property tax.

The specific items of intangibles are listed in Table 6 and consist of money-cash and bank deposits; net credits; taxable stocks and bonds; capital stock of domestic corporations; and shares of bank stock. The first three of the items listed will be discussed in this chapter and the last two categories will be treated in other chapters.

Money-Cash and Bank Deposits. Table 9 shows the percentage of equalized assessed valuations of money-cash and bank deposits to actual bank deposits in selected counties in 1961. The percentages, small as they are, actually overstate the relationships because figures are not available on actual holdings of cash. The percentages vary from zero in Hamilton and Johnson Counties to 3.11 percent in Edwards County. With the exception of Edwards, the percentages are substantially below one percent in all the counties listed in the table. In the entire State, seven counties besides Hamilton and Johnson reported no assessments of money and bank deposits. Some allowance must, of course, be made for non-taxable deposits, but even when this is done, it is apparent that only an infinitesimally small fraction of this type of property reaches the assessment roll. Sizable amounts of bank deposits, especially in large banks, are converted into tax-exempt government securities or transferred to banks in other states shortly before the effective assessment date (April 1) each year. Contrary to widespread

opinion, it does not matter that money or bank deposits may be outside the State on April 1. If owned by a resident of Illinois, it is subject to assessment.

It is not likely that money can be effectively assessed under any plan. The only practicable plan of reaching bank deposits would be to require banks to report the information and to pay the tax. Banks could recoup the tax, if they so desired by charging same against the deposits. Any proposal to utilize this method to tax bank deposits would meet strong opposition from banks and depositors alike. For this reason, and because many bank deposits are unproductive, idle balances, the better course would probably be to exempt bank deposits from the property tax. Some idea as to the loss of revenue which such exemption would entail is indicated by the fact that approximately $950,000 was derived from this source in 1960. A further argument for exempting bank deposits and cash is that these items are included in the capital stock tax (applicable to domestic corporations).

Net Credits. The item of net credits consists of certain credits less specified deductible debts. Taxable credits consist of accounts receivable, notes receivable, and accrued interest and dividends from all sources, including even accrued interest from tax-exempt stocks and bonds. Money on hand, bonds, and stocks are not included as credits. These items are required under the law to be assessed separately. Accounts payable and notes payable may be deducted from credits provided they are verified by a statement under oath filed with the assessor by the person, officer, or agent claiming them.

The equalized assessed valuation of net credits in 1960 amounted to only $12,752,109 or about 0.2 percent of total personalty assessments. About half of this amount is attributable to Cook County and the other half to downstate counties. The abstract of assessments shows no assessment of net credits in 28 counties. It is, of course, inconceivable that these counties do not have any net credits. Among downstate counties which reported assessments, the total equalized assessed valuations varied from $71 in Massac County to $878,560 in DuPage County. Some of the counties, other than Massac, that had particularly small assessments of net credits are Alexander, $278; Bond, $149; Boone, $250; Edgar, $985; Jasper, $778; Pope, $526; and Randolph, $575.

Statistics are not available as to the actual amount of net credits, but the figures suggest that the assessment of this class of property is grossly inadequate. In the light of the present unsatisfactory situation and the fact that the prospect for improvement is not encouraging, consideration should be given to exempting net credits from the property tax. Under existing conditions relative to assessments and tax rates, the removal of net credits from the list of taxable property would result in a revenue loss for all coun-

ties combined of only about $470,000 annually. This estimate makes no allowance for tax delinquency.

Stocks and Bonds. Although of questionable justification, shares of stock are legally exempt from property taxation in Illinois to a greater extent than is the case of any other category of personalty. Shares of stock issued by Illinois corporations are exempt from assessment because the intangibles of such corporations are subject to the capital stock tax. Intangibles of domestic corporations, except railroads, are not assessed directly but through the device of the capital stock tax. The hypothesis upon which

TABLE 9

Equalized Assessed Valuation of Cash-Money, Bank Deposits, and Actual Bank Deposits in Selected Counties, 1961

County	Equalized Assessed Valuation of Cash-Money, and Bank Deposits	Bank Deposits December 31, 1961	Percent
Boone	$ 19,140	$ 24,483,000	0.08
Calhoun	4,677	5,117,000	0.09
Champaign	329,930	124,910,000	0.26
Christian	24,855	39,160,000	0.06
Cook	10,462,375	15,352,533,000	0.07
Edwards	180,525	5,798,000	3.11
Fulton	45,001	45,628,000	0.10
Grundy	663	21,229,000	0.00
Hamilton	0	9,221,000	0.00
Hancock	93,495	27,918,000	0.33
Iroquois	57,000	32,667,000	0.18
Jo Daviess	21,140	27,799,000	0.08
Johnson	0	5,623,000	0.00
Kane	1,893,070	236,170,000	0.80
Knox	123,395	57,687,000	0.21
Logan	112,595	33,341,000	0.34
Marion	82,020	39,327,000	0.21
Morgan	90,014	39,068,000	0.23
Putnam	11,671	6,439,000	0.18
Randolph	180,678	34,045,000	0.53
Rock Island	505,538	194,801,000	0.26
St. Clair	420,895	327,428,000	0.13
Whiteside	120,370	66,809,000	0.18
Woodford	11,589	25,184,000	0.05

SOURCE: Bank Deposits from Rand McNally's *Banker's Directory*, 1962. Statistics on assessments from Property Tax Division, Illinois Department of Revenue.

the exemption of shares of stock in Illinois corporations is based is that the value of such shares reflects in a large part the equity of the issuing corporation, and that to tax the equity less the assessed value of tangible property under the capital stock tax and to tax the shares too would result in unwarranted double taxation. This hypothesis would have some validity if the capital stock tax were effectively administered, but as is explained in Chapter XVIII such is not the case. Intangibles of railroads in Illinois are reached thorugh the device of the unit-rule assessment that is made by the State Department of Revenue.

Even less defensible is the fact that shares of stock in foreign corporations which pay any tax on tangible property in Illinois at all are exempt in the hands of resident shareholders.[12] In view of the fact that foreign corporations are not subject to the Illinois capital stock tax, this exemption is indeed curious. If a large corporation has shareholders in Illinois who own shares worth millions of dollars, the shares are exempt from assessment if the corporation pays any tax whatever on tangible property in the state. The shares of more than 4,000 corporations are exempt from assessment in Illinois because the issuing corporations pay at least a small amount of taxes on tangible property in Illinois.[13]

Intangibles belonging to a foreign corporation and other non-residents are exempt from taxation in Illinois except when such intangibles are being used in a business in Illinois so as affirmatively to have acquired a business situs in the state.

Shares of stock in national banks located in other states are exempt from taxation in Illinois. Shares of both state and national banks located in Illinois are taxed under a special tax on bank's shares, details of which are discussed in Chapter XIX. Although seldom declared, building and loan shares are subject to assessment and are required under the law to be returned by the individual shareholders.

Direct obligations of the United States Government are exempt as are specified Federally guaranteed obligations. Securities issued by state and local governmental units, however, are subject to assessment. Bonds of both domestic and foreign corporations and mortgages owned by Illinois residents are also taxable under the property tax. A separate category for mortgages is not provided in the assessment abstract, but if any are assessed in a particular county they would logically be included in the net credits or capital stock categories. However, few mortgages are assessed.

Unless otherwise expressly provided by law, intangible property, including stocks, bonds, and mortgages, is assessed at the residence of the owner or his agent. The person owning, controlling, or holding the property on April 1 is required to file his return at the place where the property is subject to assessment.

---

[12] See *Hart* v. *Toman*, 373 Illinois 462 (1940).

[13] *List of Foreign Corporations Assessed on Tangible Property in Illinois*, Department of Revenue, State of Illinois, 1959.

The equalized assessed evaluation of stocks and bonds in 1960 amounted to $112,986,678, or only 1.7 percent of total personal property tax assessments. In the following 19 counties, no assessments of stocks and bonds were reported in 1961:

Alexander	Hardin
Calhoun	Jackson
Clay	Kendall
Douglas	Livingston
Edgar	Massac
Franklin	Menard
Gallatin	Perry
Grundy	Putnam
Hamilton	Saline
White	

For the downstate counties that reported assessments of this class of personalty in 1961, the equalized assessed valuations ranged from $67 in Tazewell County to $2,205,397 in Kane County. The amount for Cook County was approximately 90 percent of the state total. Cook County is a great financial center and individuals and trusts have large holdings of taxable stocks and bonds, but another reason for the relatively larger assessment in Cook County than in all downstate counties combined is probably that preferentially—low rates of assessment are uniformly applied to stocks and bonds in the former. A similar practice is followed in some downstate counties, but it is by no means universal. The situation as between Cook County and downstate counties is only a relative one because vigorous administration of assessments of stocks and bonds is lacking in all counties. With minor exceptions, about the only taxable stocks and bonds that reach the assessment roll are those of estates in probate, trusts, and similar holders where the information is a matter of public record.

Revenue from stocks and bonds is currently of minor significance, the estimate for the entire state in 1960 being about $4,200,000. The real significance of this class of personalty lies in the substantial capacity to pay taxes that accrues to the owners of stocks and bonds in Illinois that is not reached because of legal exception and ineffective administration.

It is estimated that total holdings of individuals in Illinois of stocks and bonds amounted to $35,900,000,000 in 1961.[14] This sum includes common and preferred stocks, corporate bonds and notes, mutual-fund shares, other investment funds, and state and local government bonds. It does not include United States Government securities as they are exempt from the local property tax. The equalized assessed valuation of stocks and bonds is

[14] Estimated from statistics published in *Statistical Series*, Release No. 1816. Securities and Exchange Commission, 1962. A factor of 7.1 percent was used in estimating the Illinois portion of the United States total. The 7.1 percent factor is an average of the percentages of personal income and taxable income of individuals in Illinois to the respective United States totals.

only about one-third of one percent of actual value of all stocks and bonds owned by individuals in Illinois.

If this class of personalty is to be continued under the property tax, the first step should be to eliminate existing exemptions to the fullest possible extent. The existing exemption of the shares of domestic corporations could apparently be removed by statutory enactment. The double taxation argument that has been used to support such exemption is not impressive. Double taxation *per se* is not objectionable; it becomes objectionable only when the ultimate effect is discriminatory and inequitable. To subject owners of shares of domestic corporations to a fair and reasonable property tax would not be objectionable. Mortgages are legally taxable in the hands of owners despite the fact that owners of real estate are taxable on the full value of their real estate without any deduction for mortgages. Corporate bonds are also taxable to owners notwithstanding the fact that corporations commonly issue such obligations to acquire tangible property on which property taxes must be paid.

To extend the property tax to the shares of foreign corporations that pay taxes on tangible property in Illinois might present a more difficult legal problem because the present exemption was stablished by a Supreme Court decision. Complex legal problems arise in the taxation of intangibles of foreign corporations that have a business situs in Illinois. In *Wheelock, Lovejoy and Co.* v. *Gill,* the Supreme Court of Illinois held that foreign corporations may not be assessed on an allocated portion of their aggregate intangibles. Such intangibles as have an actual business situs in Illinois, however, may be assessed. The question as to what constitutes business situs is a knotty legal problem. For this and other reasons intangibles of foreign corporations are seldom assessed in Illinois.

Classified Property Tax. One possible way to improve the deplorable situation that exists relative to the assessment of stocks and bonds would be to apply a low special property tax rate uniformly to all stocks, bonds, and mortgages throughout the entire State. This approach is commonly referred to as the classified property tax.

One of the major reasons for the breakdown of the taxation of intangibles under the general property system in Illinois is the high rate of taxation that would result if such property were taxed in accordance with statutory requirements.

This situation can be illustrated by an example. The average Statewide property tax rate in 1960 was \$3.70 on each \$100 of equalized assessed valuation. Original assessments in 1960 were equalized on the basis of about 50 percent of full market value. If a resident of Illinois owned \$1,000 in shares of stock which yielded 5 percent the equalized assessed value of the stock would have been \$500 and the tax would have been \$18.50 or 37 percent of the return from the investment. Citizens are unwilling to pay such a high rate of taxation on intangibles. and assessors, except in the case

of certain trusts and estates being probated, have not made a serious effort to include them in the assessment schedule.

Purely on his own initiative, the Assessor of Cook County several years ago adopted a *de facto* system of classification, and instructed the assessors to assess securities and certain other types of intangibles at preferentially-low rates. Several downstate counties have adopted similar plans but the best that can be said for such plans in Illinois is that they may have induced somewhat more voluntary reporting of intangibles than previously existed. Even in counties where intangibles have been placed in a special class with low rates, the assessments are far short of being satisfactory. Successful operation of a classified property tax requires vigorous administration on the part of assessment officials.

Classification in Other States. As previously mentioned, most other states long ago recognized the futility of attempting to tax intangibles under the general property tax and set up alternative methods of reaching them. Nineteen states and the District of Columbia exempt all or nearly all intangibles from property taxation completely and reach them in most cases through special or general income taxes. Seventeen states, including Georgia which taxes only bank shares as general property, apply to some or all intangibles low special-property tax rates, ranging from 1 mill to 5 mills on the dollar of assessed value.[15] These rates are in sharp contrast to the State-wide average effective rate of about 18 mills which prevailed in Illinois in 1960.

The seventeen states in which some or all classes of intangibles are taxed under a classified property tax are:

California	Missouri
Florida	Nebraska
Georgia	North Carolina
Indiana	Ohio
Iowa	Oklahoma
Kansas	Pennsylvania
Kentucky	Rhode Island
Michigan	South Dakota

Virginia

In only three states—Florida, Kentucky, and Virginia—are special property taxes on intangibles administered by state governments and the revenues earmarked exclusively for state purposes. Indiana, Michigan, Missouri, and North Carolina administer special intangible property taxes at the state level, but share the proceeds with their local governments. In California, Georgia, Iowa, Kansas, Nebraska, Oklahoma, Pennsylvania, Rhode Island, and South Dakota, such taxes are locally administered and collec-

[15] United States Bureau of the Census, *Property Tax Assessments in the United States*, p. 5, 1957.

tions are retained for local purposes. The situation is mixed in Ohio with some of the taxes on intangibles collected by the state government and some by the local governmental units.

With a few exceptions, particularly Ohio, states which levy preferentially-low rates on intangibles do not derive a substantial amount of revenue from such taxes. Special low rates on intangibles are not in themselves a panacea for the taxation of such property. Effective administration is equally as important as low rates.

Taxation of Intangibles in Ohio. The special property taxes applicable to intangibles in Ohio are especially worthy of mention. As previously mentioned, some of these taxes are collected by the state government and some by the local governmental units. The former are taxes that have a state situs and the latter are those that have a local situs. State situs intangibles include shares and deposits in financial institutions, shares of and intangibles owned by intercounty corporations, and shares of and intangibles owned by public utility companies. To the extent that they are used in and arise out of business transacted in Ohio, intangibles of nonresidents are taxable. Conversely, intangibles belonging to residents of Ohio which are used in and arise out of business outside of Ohio are not taxable.

State situs intangibles are assessed through the agency of the Auditor of State and the taxes are collected by the State Treasurer. Local situs intangibles are assessed through the agency of the county treasurer. Revenues from the locally collected taxes are distributed to the county, library boards, and municipalities on the basis of budget allowances by the county budget commission.

Details relative to categories of intangibles, tax rates, and levies of the Ohio plan are presented in Table 10. That the Ohio method of taxing intangibles produces a substantial amount of revenue is evidenced by the fact that total tax levies on such property amounted to $64,789,578 in 1960. Of the total amount, $32,566,618 represented local situs intangibles and $32,-222,960 represented state situs intangibles. For the entire group, the largest item was local situs productive investments, namely $28,103,428; and the next most important item was bank deposits, $14,707,958. For purposes of administration, productive investments are defined as investments which have yielded income during the preceding calendar year. It will be noted that the rate on productive investments is based on income (5 percent of income yield), whereas the rates on other investments are flat ad valorem rates.

The categories of intangible personalty in Illinois which compare roughly with the over-all coverage of the Ohio plan are money-cash and bank deposits, net credits, stocks and bonds, capital stock of domestic corporations, and shares of bank stock. The equalized assessed valuation of these categories in Illinois in 1960 amounted to $1,002,021,023.

Based on the statewide average tax rate for 1960 and assuming no tax

TABLE 10

Taxes Levied at Special Rates on Intangibles in Ohio, 1960

Situs and Form of Property	Rate	Levies*
Local Situs		
Productive Investments	5 percent of income yield	$28,103,428
Unproductive Investments	2 mills	1,796,367
Deposits	2 mills	187,465
Credits	3 mills	2,151,392
Money and Other Intangibles	3 mills	327,972
Total—Local Situs		$32,566,618
State Situs		
Public Uitlity Companies:		
Productive Investments	5 percent of income yield	$ 42,864
Unproductive Investments	2 mills	12,460
Deposits	2 mills	31,781
Credits	3 mills	30,912
Money and Other Intangibles	3 mills	9,117
Total		$ 127,134
Intercounty Corporations:		
Productive Investments	5 percent of income yield	$ 221,657
Unproductive Investments	2 mills	98,746
Deposits	2 mills	336,248
Credits	3 mills	1,535,631
Money and Other Intangibles	3 mills	172,889
Total		$ 2,365,171
Financial Institutions:		
Deposits in: Banks	2 mills	$14,707,958
Building and Loans	2 mills	9,734,401
Credit Unions	2 mills	252,743
Shares in: Banks	2 mills	1,921,426
Building and Loans	2 mills	974,355
Credit Unions	2 mills	23,609
Total		$27,614,492
Dealers in Intangibles:		
Intangibles	5 mills	$ 1,089,851
Domestic Insurance Companies	———†	1,026,312
Total State Situs		$32,222,960
Grand Total		$64,789,578

SOURCE: The Ohio Department of Taxation, p. 66, 1961.
*Items may not add to totals due to rounding.
†A franchise tax.

delinquency, this assessment should have produced about $37,000,000 in revenue or 57 percent of the $64,789,578 obtained from intangibles in Ohio. If in 1960 Illinois had been using the same plan that was in effect in Ohio and with comparable administrative effectiveness, it is estimated that total tax levies on intangibles would have amounted to about $75,000,000. The higher figure estimated for Illinois results from the fact that total personal income in Illinois in 1960 was about 16 percent higher than it was in Ohio. It was assumed that the amount of intangibles owned in Illinois was higher than that in Ohio by approximately the same percentage.

Administrative Considerations. Numerous references have been made above to the importance of good administration. It would be unwise to adopt a statewide system of special tax rates on intangibles in Illinois unless it was expected that the plan would be effectively administered and rigidly enforced.

First of all, the problem of jurisdiction and administrative organization requires careful consideration. It can be categorically stated that the administration of a classified property tax on intangibles in Illinois could not be adequately handled by elective township assessors or their appointive counterparts in counties under the commission form of government. It is doubtful whether many counties at present are well equipped to handle the task. Certainly it should not be assigned to the county treasurer who already has heavy responsibilities. A few counties now have well qualified assessment supervisors, who with an adequate staff and necessary facilities could assess intangibles of individuals and intracounty corporations in a satisfactory manner. Intangibles of intercounty corporations could be assessed most effectively by a State agency. A State agency would also be preferable for the assesment of the intangibles of foreign corporations that have a business situs in the State.

Among the devices that should be used in the assessment of intangibles are:

1. Collection at source if tax is levied on bank deposits.
2. Use of copies of Federal income tax returns to check on ownership of intangibles, if intangibles are retained under the property tax.
3. Require domestic corporations to file annual statement of stockholders who live in the State, together with their addresses and number of shares owned.
4. Same as (3) above for resident shareholders of foreign corporations who are legally "engaged in business" in the State.
5. Require that tax on evidence of debt be paid before suit is filed by creditor to collect.
6. Clarify the legal definition of *business situs* as the term relates to the taxation of the intangibles of a foreign corporation doing business in the State.
7. If legally possible, provide optional dates for the assessment of in-

tangibles to avoid conversion of taxable investments into tax exempt Federal securities just prior to effective assessment date.

8. Check records of county recorder for mortgages and other evidences of indebtedness recorded.
9. Check records of probate courts for inventory of intangibles in estates filed for probate.

Income Tax Approach. Of the 13 states that levy special property taxes at the state or local level, 9 of them also have state individual income taxes which include income from intangibles in the income tax base. These are California, Georgia, Iowa, Kansas, Kentucky, Missouri, North Carolina, Oklahoma, and Virginia. The fact that both special property tax rates and general individual income taxes are levied in these nine states may have some bearing on the mediocre success of the former. It should be noted that Ohio which has the most successful special property tax on intangibles does not have a state individual income tax. The Ohio tax is based on yield in the case of productive investments, but it is levied as a special property tax. Although real estate is subject to the income tax as well as to property taxes in states that have individual income taxes, it appears doubtful whether similar treatment should be extended to intangibles. The better course of wisdom in the case of intangibles would seem to be to employ one or the other method but not both.

All or nearly all intangibles are exempted from the property tax in 19 states as follows:

Alabama	Mississippi
Arizona	Nevada
Colorado	New Hampshire
Connecticut	New Jersey
Delaware	New York
Idaho	Oregon
Maryland	Utah
Massachusetts	Vermont
Minnesota	Washington
Wisconsin	

All of these states except four—Connecticut, Nevada, New Jersey, and Washington—reach intangibles through a special or general income tax. Of the 19 states listed, New Hampshire levies a special income tax on intangibles. A special income tax is also applicable at the state level to intangibles in Tennessee, although certain classes of intangibles are also subject to local property taxes in Tennessee.

With certain exceptions, the special state income tax on intangibles in New Hampshire applies to income received from intangibles by individuals. It does not apply to income from intangibles held by corporations. The rate

of the tax is 4.25 percent and the exemption is $600.[16] Revenues, which amounted to $1,631,000 in 1961, are distributed entirely after deduction of about 1 percent for administrative costs to cities and towns. Because of the liberal personal exemption and the exemption of corporation intangibles, the revenue significance of this tax is small.

The rate of the special tax on income from stocks and bonds in Tennessee is 6 percent except that a 4 percent rate is applicable in the case of income from stock in any corporation assessed for ad valorem taxes on its corporate property, if 75 percent of the total corporate property (including the franchise) is assessable in Tennessee. This tax, like the New Hampshire measure, applies only to individuals, although corporations in Tennessee are liable for a 3.75 percent excise tax on income from intangibles. No liability is incurred under the law on income from any stock in any corporation where the value of the shares are assessed ad valorem to the stockholder in the state. A personal exemption of $25 is provided in the law. Collections in 1961 amounted to $5,984,000. Part of the revenues go to the General Fund of the State Treasury and part to cities and counties. Because of the limited experience with special income taxes on intangibles, it is difficult to appraise their success. The experience of New Hampshire and Tennessee, although admittedly not wealthy states, is not particularly impressive. Of the two states, Tennessee appears to have the better plan.

Of the 14 states that depend primarily upon the general individual income tax as a method of reaching income of individuals from intangibles, Colorado, Massachusetts, and Maryland single out such income for special treatment. Colorado imposes a surtax on gross income from intangibles in excess of $5,000, the rate of which is 2 percent. The normal rates on income range from 3 percent on the first $1,000 to 9 percent on amounts over $10.000. Personal exemptions in Colorado are $750 for a single person, $1,500 for a married person, and $750 for each dependent. Federal income taxes are deductible in computing the base.

The Massachusetts tax is really a classified income tax, the basic rate of which on interest and dividends in 1961 was 7.38 percent. The basic rate on earned income, professional income and annuities in 1961 was 3.075 percent. Personal exemptions in Massachusetts are $2,000 for a single person, $2,500 for a married person, and $400 for each dependent. Federal income taxes are deductible.

The rate of tax on investment income in Maryland is 2 percent on the first $500 and 5 percent on the amount in excess of $500. The rate of non-investment income is a flat 2 percent. Personal exemptions are $800 for a single person, $1,600 for a married person, and $800 for each dependent. Federal taxes are not deductible in computing the base for state income tax purposes in Maryland.

---

[16] Facts pertaining to income tax rates, exemptions, etc., are from Commerce Clearing House, *State Tax Reporter* for individual states.

Of the states in which income from intangibles is treated the same as other income, the rates range from 1 or 2 percent to 5 or 6 percent in most cases. Personal exemptions vary widely among the states, but in most cases they are substantially higher than are such allowances under the Federal law.

The case for employment of a state individual income tax as a method of taxing income from intangibles depends to a considerable extent upon whether it is desirable to levy such a tax to reach other income. If this be the case, as the writer believes, then it would be desirable to include the income from intangibles in the coverage of such a general income tax. In the opinion of the writer, the income tax approach, especially with a general income tax, is superior to the classified property tax approach as a method of reaching intangibles. The former has definte administrative advantages over the latter. This is especially true where Federal income tax returns are used to facilitate compliance. The income tax, moreover, is the most equitable of all taxes. It provides an effective method of reaching lucrative incomes from professional services. Whether adoption of a flat rate or a graduated individual income tax in Illinois would require a constitutional amendment is discussed in the chapter on Constitutional Problems. The chief objection to the levy of a state individual income tax is that the Federal Government has already so fully exploited the income tax field. If a special property tax on intangibles is adopted in Illinois on a statewide, uniform basis, the tax should be levied upon the yield as is the current practice in the case of productive investments in Ohio. Yield is a more equitable base for such a tax than assessed value.

Registration and Recording Taxes. A few states have adopted registration or recording taxes as a method of taxing certain classes of intangibles. In most cases, such taxes are in lieu of property taxes but in addition to state income taxes. Among the states which have adopted such measures are Alabama, South Carolina, New York, Minnesota, Georgia, and Florida.

The Alabama statute applies only to foreign securities owned by residents of the state of Alabama. Under the law no ad valorem tax may be assessed upon any security upon which the registration tax has been paid. If this tax is not paid, however, the securities become liable for ad valorem taxes. The rate of the tax is 25 cents per $100 of par value and the yield of the tax for the year ending September 30, 1961, was $59,827. The tax is paid at the time of registration and does not become due again until the securities are transferred to a new owner. Income from intangibles in Alabama is subject to the state individual and corporation income taxes.

South Carolina has a documentary stamp tax that is imposed upon written obligations to pay money, stocks, notes, and mortgages. Intangibles are not specifically exempt from local property taxes in South Carolina, but they have not been assessed for property tax purposes for many years. The rate of the documentary stamp tax on bonds and the original issue of

capital stock is 10 cents per $100; and the rate on transfers of shares of stock is 4 cents per $100. Collections from this tax for the year ended June 30, 1961, amounted to $1,430,772. Income from intangibles in South Carolina is subject to state individual and corporation income taxes.

New York has a mortgage recording tax, the rate of which is 50 cents on each $100. Net receipts are reported by the county recording officers for the year ended March 31, 1961, amounted to $18,898,701. Mortgages and other intangibles are not subject to property taxation in New York, but income from such sources is taxable under the state's individual and corporation income taxes.

Minnesota has a mortgage recording tax of 15 cents on each $100. All mortgages upon which the registry tax has been paid, together with the debts or obligations secured thereby, are exempt from property taxation. Other intangibles have been exempt from property taxation in Minnesota since 1943, but income from intangibles, including mortgages, is subject to state individual and corporation income taxes. County treasurers who collect nearly all of morgage registry tax collections reported receipts of $1,535,905 from this source in 1961. Collections from the mortgage registry tax are apportioned one-sixth to the state, one-sixth to the county, and the remainder is divided between the school district and the municipality in which the real estate is located.

Mortgages are excluded from special property taxes on intangibles in Georgia, but are subject to a 1½ mill recording tax. A similar situation prevails in Florida where a 2 mill recording tax is imposed on mortgages. Georgia has both a state individual and a corporation income tax, but Florida has neither type of levy.

With the exception of New York, registration and recording taxes produce an inconsequential amount of revenue, and should probably be designated as nuisance taxes. Whether from the standpoint of theory or practice, it does not appear that a strong case can be made for such levies.

CHAPTER XIII

BURDEN OF PROPERTY TAXES ON ILLINOIS AGRICULTURE

By R. G. F. Spitze and W. H. Heneberry*

Nature of Property Tax in Illinois

Farmers in Illinois pay almost every tax levied on a citizen of the State, but the nature and magnitude of the property tax make it easily one of the most, if not the most, burdensome. The burden that this tax places upon Illinois agriculture is related to two conditions, namely: it is almost exclusively a local levy, and Illinois governments rely heavily upon if for revenue.

First a look at the property tax as a local levy. The property tax long ago ceased to be a technique of public support of the federal and most state governments that could be uniformly administered across state or county lines, utilizing specially trained personnel. Increasing needs for state aid, dependent upon adequacy of the local tax base, make uniformity in tax matters a crucial issue. Except for state aid requirements, assessment supervision provided by the state department of revenue, and rate limitations set by state statutes, each local government is essentially its own policy-maker in property tax matters. Thus assessment becomes a local function, usually at the township level, with specialized help of a county supervisor in the more fortunate counties. The adequacy and equity of this functioning depend upon local financial resources available for support, quality of complementary government services, and ability of local personnel upon whom responsibilities rest.

Reliance upon well-intentioned but hurried nonprofessional personnel, along with inadequacies in the statutes, discourages thorough assessments on intangible, inaccessible, and unfamiliar property. Farm property, both personal and real estate, is generally easily visible as land, buildings, machinery, livestock, or feed inventory; is as accessible to any examiner as a walk around the farmstead or a latch on a building door; and is familiar to anyone reared in a rural community. On the other hand, use of such personnel encourages complete assessments on standardized types of property and on property for which current market value is readily obtainable. Much farm property, such as tractors, livestock, and trucks, is similar from owner to owner. Furthermore, much of it has a value that is easily discernible on commodity market pages or in deed record books. The familiar farmstead is somewhat easier to transcribe to an assessment roll than is a

*The authors are Associate Professor of Agricultural Economics, University of Illinois, and Agricultural Economist, Economic Research Service, United States Department of Agriculture, respectively.

complex supermarket or manufacturing concern. Likewise, a tendency may exist to undervalue an improved 200x200-foot residential or commercial lot while overvaluing an improved 200-acre tract of cropland and to underassess high-priced property in relation to low-priced property.

The second condition responsible for the property tax burden on Illinois agriculture is the heavy reliance the local governments place upon this tax to meet their revenue needs. Any burden it places on farmers compared with others is compounded by its prominence as a revenue source. One of the public services that has mushroomed fastest in recent years is primary and secondary education, and the property tax has had to carry an increasing absolute load for its support. The cost of other services of a more urban character, such as sanitation, utilities, welfare, police and fire protection, and recreation, also falls heavily on the property taxpayer. Although heavy dependence is placed on the property tax throughout the United States,

TABLE 1

Proportion of Property Taxes to Governmental Tax Revenues, 1960

	Local Government	Local and State Government
Illinois	88.1%	52.7%
United States	87.4	45.4

SOURCE: U. S. Department of Commerce, *Government Finances in 1960.*

this tax assumes a larger role in Illinois than in the country as a whole (Table 1). Furthermore, this role has increased somewhat since 1953.

Economic Basis of Property Tax on Farm Property

Years ago, to tax property was to tax farm property. The economy was largely agricultural; it was in the rural areas that most of the wealth existed and the income originated. Today, with the major part of the nation's population, employment, capital, and income in the off-farm sectors, the historical prominence of property as the tax base merits review. In 1960 Illinois farm residents accounted for 5.6 percent of the total State population and only 2.4 percent of the income, but farm property still provided 13.3 percent of the property taxes (Table 2). This burden has persisted, if not worsened, since 1953.

Farmland is still a marketable asset for the owner, but it has lost its position as a primary indicator of wealth. Most of the wealth of the nonfarm economy assumes a form other than land. Even the farmer now has 33 percent of his total assets in forms other than real estate, and if buildings were included the percentage would be substantially higher.[1] If the property

[1] *Balance Sheet of Agriculture 1962*, USDA, p. 2.

tax is designed to tax wealth, the vast array of wealth now supplementing the land resource both on and off the farm must be tapped.

Most farm property serves as a productive factor input, and yet its use does not insure a certain income. On the average, for the United States, the estimated rate of return on farm real estate capital declined from about 8 percent in the early 1950's to 3 percent in 1959 when all farm labor was figured at the same rate as hired labor.[2] More specifically for Illinois, analysis of records on farms in a 180- to 259-acre group shows an average capital and management return of $5,700 for the past ten years in northern Illinois. These farms were using at least $100,000 worth of capital.[3] Thus,

TABLE 2

Share of Property Taxes Borne by Illinois Agriculture Compared With Population and Income, 1953 and 1960

	Farm Property Taxes As Proportion of Property Taxes	Personal Net Farm Income as Proportion of Total Personal Income	Farm Population As Proportion Of Total Population
1953	15.3%	4.1%	7.8%*
1960	13.3	2.4	5.6

SOURCE: U. S. Department of Commerce, *Government Finances in 1960;* U. S. Department of Commerce, *State and Local Finances in 1942 and 1957;* USDA, *Supplement to the Farm Income Situation for July 1962,* U. S. Department of Commerce, *Survey of Current Business,* August 1961; U. S. Department of Commerce, *Personal Income by States Since 1929;* U. S. Department of Commerce, *U. S. Census of Population,* 1960, PC (1)-15C.

*Estimated

even though farm property represents a marketable asset, its income-producing power has apparently diminished recently.

There is convincing evidence that a gap exists between the per capita net incomes of people living off farms and the lower incomes of the farm population. Yet farm people bear the burdens of rearing families and supporting public education programs for the large number of farm youth who migrate to urban sectors for their productive years.

Comparative Burden of the Illinois Farm Property Tax

Taxes on farmland vary widely within and among states. This section will show some of the differences in tax loads among various areas of the State, between economic sectors of Illinois, and between Illinois and other states. The tax pattern for one state may not necessarily be desiarble for other states; yet an appraisal of tax problems and alternatives of one state can benefit from experiences of other states.

Within Illinois Agriculture. Taxes can be viewed in many ways. One is the view of the individual farmer as businessman and income earner.

[2] *Current Developments in the Farm Real Estate Market,* USDA, February 1960, p. 24.

[3] *1961 Summary of Illinois Farm Business Record,* Illinois Agricultural Extension Service Circular 853, p. 3-5.

Table 3 shows the average real estate taxes levied in 1960 on each owner of a farm as defined by the census. In the same year, total net farm income, before real estate taxes were paid, for all farms in Illinois, by census definition, averaged $5,300 as returns to labor, management, and owned capital. For only the more commercial-type farms of 180-259 acres keeping records in a management service sponsored by the University of Illinois, the total personal and real estate property taxes per farm averaged from $850 in southern Illinois to $1,473 in northern Illinois in 1959.[4] These farmers had higher incomes than the over-all average above.

TABLE 3

Average Farm Real Estate Property Taxes in Illinois, 1960

Taxes per farm	$796.00
Taxes per acre	4.07
Taxes per $100 value of real estate	1.27
Taxes per $1,000 net farm income before property taxes	150.21

SOURCE: U. S. Department of Commerce, *Census of Agriculture, Illinois, 1959;* USDA *Farm Real Estate Taxes,* RET-1, June 1961.

The size of the tax burden also depends on the extent to which a particular rate of levy varies with the income out of which all taxes must be paid. This is a crucial consideration, since taxes are usually paid from the current or preceding year's income. While the total payment changes little from year to year, farm income is much more variable. Thus, the tax burden relative to income may be greater in some years than in others. This variability and the upward trend in Illinois farm property tax burden in the last 11 years is shown in Chart 1.

Some measure of differences in taxes per acre in various parts of Illinois can be obtained from data secured in the annual USDA Economic Research Service survey of farm real estate taxes. The small size of the sample in some areas makes these estimates somewhat less reliable than previous estimates for the entire state. However, the differences in tax loads appear to be consistent with what might be expected. Taxes in the Chicago metropolitan area were twice as high as the state average in 1960, while those in rural counties were only about half as high as the state average.[5] (Table 4, Chart 2). The estimate for the Chicago area would have been even higher if Cook County had been included.

Another source of information on Illinois farm real estate taxes is the farm account records kept by 5,500 farmers in cooperation with the Uni-

---

[4] Kransz, N.G.P., A. G. Mueller, and R. B. Gomein, *Property Taxes Paid by Illinois Farmers,* Illinois Agricultural Experiment Station AERR-51, July 1962, p. 6.

[5] Counties were classified "metropolitan" in accordance with Bureau of the Budget Publication, "Standard Metropolitan Statistical Areas" (Washington, 1961). Rural counties are those that are neither metropolitan nor adjacent to metropolitan counties. This definition differs from the census definition, which classifies as rural only those counties having no population centers of more than 2,500.

versity of Illinois and the Farm Bureau Farm Management Service. These farms are considerably larger in terms of both acreage and investment and are presumably better managed than the farms in the USDA survey. They

CHART 1

Total Farm Personal and Real Estate Property Taxes per $1,000 Net Farm Income, Illinois, 1949-1960.

SOURCE: USDA, *Supplement to Farm Income Situation for July 1962.*

TABLE 4

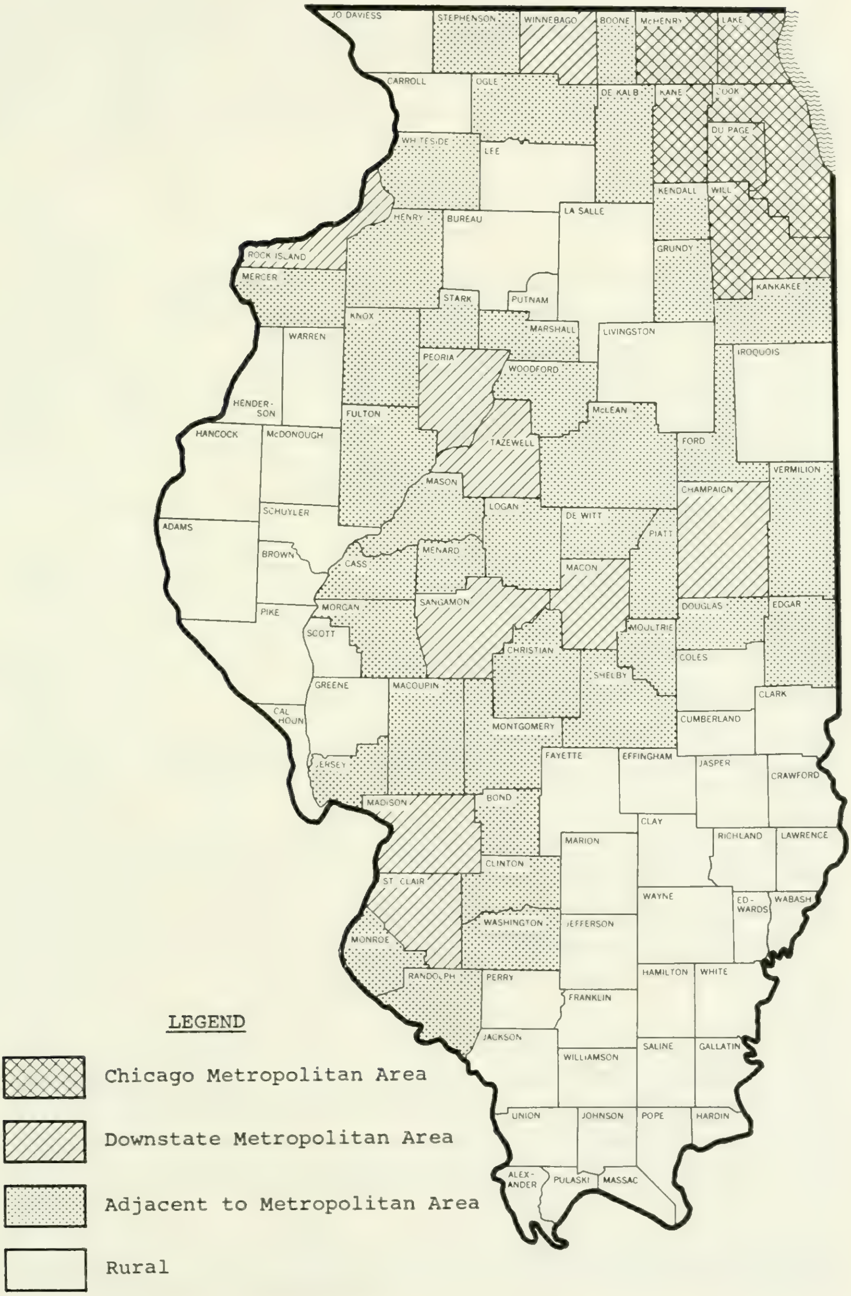
Farm Real Estate Taxes Per Acre, by Type of County, Illinois, 1959 and 1960

Type of County	Number of Counties In State	Number of Counties In Sample	Number of Farms in Sample	Taxes Per Acre 1959	Taxes Per Acre 1960	Percent Change
Metropolitan*	15	5	62	5.44	5.62	+3.3
Downstate	(9)	(3)†	(38)	4.59	4.74	+3.3
Chicago	(6)	(2)‡	(24)	7.91	8.14	+2.9
Adjacent to metropolitan	38	17	274	4.46	4.60	+3.1
Rural	49	38	367	2.11	2.19	+3.8
State	102	60	703	3.93	4.07	+3.6

SOURCE: Unpublished data from annual USDA survey of farm real estate taxes, compiled by W. H. Heneberry.
*Classified according to "Standard Metropolitan Statistical Areas," Bureau of the Budget, Washington, D. C., 1961.
†Champaign, Peoria, and Rock Island counties.
‡DuPage and Kane counties.

CHART 2

Types of Counties, Illinois, 1960



are more representative of commercial agriculture, while the farms in the USDA survey may represent a wider variety of economic classes of farms. A recent publication provided information concerning taxes paid on these farms from 1951 through 1959.[6] On rented farms, information was available on tax payments by both landlords and tenants from 1955 through 1959. Landlords paid the real estate taxes on these farms; in 1959 these payments were estimated to be $4.28 per acre in northern Illinois and $2.48 in southern Illinois (Table 5).

TABLE 5

Farm Real Estate Taxes Per Acre on Rented Farms in the Farm Bureau Farm Management Service, Illinois, 1955-59

Areas	1955	1956	1957	1958	1959
Northern Illinois*	$3.57	$3.86	$4.03	$4.76	$4.28
Southern Illinois*	1.68	1.93	2.02	2.24	2.48

SOURCE: Adapted from Krausz, *et. al., op. cit.*, p. 6, Table II.
*The division between northern and southern Illinois is approximately a line from Jacksonville to Mattoon.

Between agriculture and the rest of the economy in Illinois. Tax burdens can exist in absolute terms for any bearer, and they can also be considered in relation to what other taxpayers pay. Mainly because of the historical prominence of farmland as the primary tax base, the reliance of Illinois local rural government on the property tax, and tax assessment practices, the share of the property tax borne by farmers in Illinois remains high in relation to that paid by other groups. Table 6 compares these relative shares for *agriculture and the total Illinois economy, including agriculture.* Farmers' property tax payments on personal property and real estate increased from 10 percent of total net farm income before property taxes in 1949 to 20 percent in 1960. In 1960, for the entire Illinois economy, property taxes took only 4 percent, with more gradual increases evident. Furthermore, in 1960 the per capita property tax payment was $259 for the farm population compared with $109 per capita for the total Illinois population.

Another view is provided in a recent report by G. W. Fisher.[7] When Illinois counties were grouped primarily according to location and agricultural characteristics, local government general revenue as a percent of personal income was found to be highest for the most agricultural counties, being almost double that of the least agricultural counties. The assessment-income comparisons between agricultural and industrial counties are even

[6] Krausz, Mueller, Gomein, *op. cit.*

[7] Fisher, G. W., "Illinois Local Government Finance: Geographic Variations," *Illinois Government*, University of Illinois Institute of Government and Public Affairs, April 1962.

more dramatic, the ratio being almost three times as large for the agricultural as for the industrial group.

Between Illinois and other states. Comparisons of *real estate farm property taxes* among the several states are presented to show differences in total taxes and in taxes per unit of value and per unit of income. Because it is impossible, with available data, to separate taxes on land from those on buildings, the taxes reported here are on farm real estate rather than on bare land. Differences in tax loads among states often result from variations in state-local fiscal interrelationships, as well as from variations in farmland acreages and values, farm income, property tax administration, and levels of tax-supported services.

1. **Total taxes.** Illinois, with its large acreage of highly productive farmland, might be expected to have higher farm real estate taxes than other states. In fact, it does. The annual survey of farm real estate taxes made by the Economic Research Service, United States Department of Agriculture, shows that tax levies in Illinois in 1960 amounted to $123.1 million, second only to California.[8] (Table 7). Illinois accounted for 9.6 percent of the taxes levied on all farm real estate in the United States.

2. **Taxes per acre.** In terms of real estate taxes per acre, Illinois farms carry a relatively heavy load. With an average tax of $4.07 per acre, Illinois ranked fifth in the nation, after New Jersey, Connecticut, Massachusetts, and Rhode Island. These four states have very small acreages of farmland, most of it in or near metropolitan areas, where values are high because of potential uses of land for nonfarm purposes and because of the increased demand for local government services due to suburban development. Moreover, the average size farm in these states is only about half as large as in Illinois, so a higher proportion of the tax is on the farm dwelling than in Illinois.

3. **Taxes per $100 value of property.** Because of differences in values per acre among the states, the tax per acre has some shortcomings as a measure of tax loads. Measurement in terms of taxes per $100 of value is therefore desirable. In this respect, Illinois ranks below most of the New England states, as well as below South Dakota, Nebraska, Wisconsin, and Minnesota. It has the highest tax in the Corn Belt, however, and is far above most of the southern and western states.

4. **Taxes per $1,000 income.** Comparisons of taxes with income provide an important measure of tax loads, because taxes are usually paid from current income or income from the preceding year. In this comparison, both taxes and income are presented as averages of 1959 and 1960 in order to reduce the effect of year-to-year variations in income. Illinois farm real estate tax levies averaged $150.54 per $1,000 of net farm income before payment of property taxes. This was the fifth highest tax in the nation, being

[8] *Farm Real Estate Taxes*, RET-1, Economic Research Service, United States Department of Agriculture, Washington, D. C., June 1961.

TABLE 6

Comparison of Shares of Income Taken by Property Tax for the Agricultural Sector and for the Total Economy of Illinois, 1949-1960

Year	Agricultural Sector				Total Economy			
	Total Personal and Real Estate Property Taxes on Farm Property	Total Net Farm Income Before Property Tax Paid, Excluding Off-Farm Rent	Proportion of Farm Property Taxes to Net Farm Income	Average Farm Property Tax Per Capita of Farm Population	Total Personal and Real Estate Property Taxes	Total Personal Income	Proportion of Property Taxes to Personal Income	Average Property Tax Per Capita of Total Population
	(million)		(percent)		(million)		(percent)	
1949	$ 74.3	$712.2	10.4	—	—	$14,654	—	—
1950	80.5	829.3	9.7	$105	—	15,984	—	—
1951	85.4	988.1	8.6	—	—	17,777	—	—
1952	92.7	923.4	10.0	—	—	18,579	—	—
1953	96.9	811.3	11.9	—	632.6	19,669	3.2	$ 71
1954	101.8	870.8	11.7	—	—	19,751	—	—
1955	108.7	723.6	15.0	—	—	20,968	—	—
1956	114.3	866.4	13.2	—	—	22,857	—	—
1957	125.6	853.2	14.7	—	895.7	23,941	3.7	—
1958	134.6	875.0	15.4	—	915.7	24,100	3.8	—
1959	139.7	699.1	20.0	—	899.5	25,643	3.5	—
1960	145.7	712.4	20.5	$259	1,098.3	26,425	4.2	$109

SOURCE: USDA, *A Supplement to the Farm Income Situation for July 1962;* U. S. Department of Commerce, *State and Local Government Finances in 1942 and 1957, 1958, 1959, 1960;* U. S. Department of Commerce, *Personal Income by States Since 1929;* U.S. Department of Commerce, *Survey of Current Business,* August 1961; U. S. Department of Commerce, *Census of Population, 1950, 1960.* Data not available for some years.

TABLE 7

Taxes Levied on Farm Real Estate by States and Regions, United States, 1960

State and Region	Taxes: Total*	Per Acre*	Per $100 Value†	Per $1,000 Net Farm Income‡
	(million dollars)	(dollars)		
Maine	6.4	1.76	1.97	103.50
New Hampshire	3.4	2.36	2.09	221.40
Vermont	4.8	1.46	1.68	145.11
Massachusetts	9.4	6.70	1.99	219.45
Rhode Island	.8	5.35	1.20	129.03
Connecticut	7.9	7.02	1.57	159.66
New York	44.7	2.98	2.01	145.16
New Jersey	17.1	10.35	1.81	165.80
Pennsylvania	31.2	2.38	1.23	116.70
Delaware	.9	1.06	.42	31.91
Maryland	7.7	1.99	.70	95.05
Northeast	134.3	2.96	1.54	134.80
Michigan	32.9	2.01	1.04	110.19
Wisconsin	54.9	2.44	1.82	111.99
Minnesota	76.7	2.39	1.54	132.13
Lake States	164.5	2.32	1.48	120.12
Ohio	45.2	2.27	.92	111.28
Indiana	45.9	2.39	.88	104.47
Illinois	123.1	4.07	1.27	150.54
Iowa	103.6	3.05	1.17	113.13
Missouri	32.8	.96	.85	61.42
Corn Belt	350.5	2.55	1.07	112.83
North Dakota	22.0	.55	1.04	87.43
South Dakota	29.5	.76	1.46	107.22
Nebraska	58.8	1.27	1.43	117.88
Kansas	60.2	1.21	1.18	111.07
Northern Plains	170.5	.98	1.29	108.68
Virginia	11.8	.80	.56	56.24
West Virginia	2.8	.39	.51	57.85
North Carolina	15.0	.83	.42	24.62
Kentucky	14.5	.80	.57	43.53

TABLE 7 (Continued)

State and Region	Taxes: Total*	Per Acre*	Per $100 Value†	Per $1,000 Net Farm Income‡
	(million dollars)	(dollars)		
Tennessee	11.2	.63	.46	40.14
Appalachian	55.2	.73	.49	37.41
South Carolina	5.8	.52	.36	30.70
Georgia	9.3	.39	.36	30.78
Florida	18.3	1.04	.45	42.17
Alabama	6.6	.32	.34	27.28
Southeast	39.9	.54	.38	34.10
Mississippi	10.6	.52	.47	34.17
Arkansas	11.9	.67	.62	36.74
Louisiana	6.3	.57	.32	33.88
Delta States	28.8	.58	.46	35.12
Oklahoma	17.9	.52	.58	60.55
Texas	67.3	.47	.53	64.80
Southern Plains	85.1	.48	.54	63.83
Montana	17.2	.32	.86	97.81
Idaho	16.4	1.28	.98	104.25
Wyoming	5.1	.18	.77	74.18
Colorado	21.2	.61	1.04	106.68
New Mexico	3.7	.11	.36	38.54
Arizona	8.8	.56	.65	61.43
Utah	6.7	.67	.89	118.79
Nevada	1.3	.19	.50	76.92
Mountain	80.4	.41	.79	88.13
Washington	16.4	1.04	.65	74.22
Oregon	22.1	1.13	1.16	129.54
California	136.3	3.84	.96	107.09
Pacific	174.7	2.47	.96	104.93
48 States	1,284.0	1.20	.99	88.96

**Farm Real Estate Taxes*, RET-1, Economic Research Service, U. S. Department of Agriculture, June 1961.
†Value of farm real estate is based on 1959 Census of Agriculture data, adjusted to 1960 by use of U. S. Department of Agriculture index numbers of farm real estate values.
‡Average of 1959 and 1960 data on taxes and income. Net farm income here means total net farm income (including rental value of farm dwellings and value of farm products used in the household), plus net rent to nonfarm landlords, before payment of farm real estate taxes.

exceeded only by New Hampshire, Massachusetts, New Jersey, and Connecticut. The average for all states was $88.96.

5. **Trends among surrounding states.** Patterns of taxation have been changing recently in many states. Chart 3 shows the trends in farm real estate taxes per $1,000 income over the past ten years in Illinois and surrounding states. Three periods are used, each with two-year averages to eliminate wide year-to-year variations. It is evident from this tax-income measure that the property tax burden has intensified for farmers in Illinois more than that in all but two surrounding states, being the same in Missouri and surpassed only by Michigan.

The Question of Shifting the Farm Property Tax Burden

Evidence of the original impact of the farm real estate tax has been presented previously. The final impact of a tax may differ from the original if taxpayers can shift all or part of the tax to other individuals or groups. Three types of shifts can occur for the farm property tax under specified conditions: (1) a forward shift in the form of higher prices for farm products; (2) a backward shift in the form of lower returns to hired farm labor and/or other purchased items involved in production; and (3) capitalization in the form of lower prices to buyers of farmland.

Forward shifting could occur if producers possessed power to collectively restrict production sufficiently to include the amount of the tax in the product price. This method does not appear possible in view of the rapid increase in farm production in recent years. More reasonably, forward shifting might also occur in cases where imposition of a new tax or an increase in rate on an existing one took marginal land out of production. The resulting restriction on supply would enable the remaining producers to raise prices by an amount depending on the price elasticity of demand.

Backward shifting in the form of lower returns to farm labor can occur if farmers are able to reduce wage rates and still retain their supply of hired labor. But hired labor is much less important than operators' labor on most farms, so a more crucial question is whether earnings to operators' labor and capital (including working capital, such as seed, feed and fertilizer) are reduced by taxes on real estate. To owner-operators such a question would be of only academic interest, since they also furnish labor, land, and capital. Tenants' labor and/or capital returns could be reduced if landlords were able to pass on property taxes in the form of higher rents.

Capitalization can occur when buyers of farmland, knowing the pattern of present and future taxes, discount their offers by the capitalized value of the annual tax. The sellers thus pay future taxes in the form of reduced selling prices. This type of shifting occurs most readily during periods of decreasing land prices.

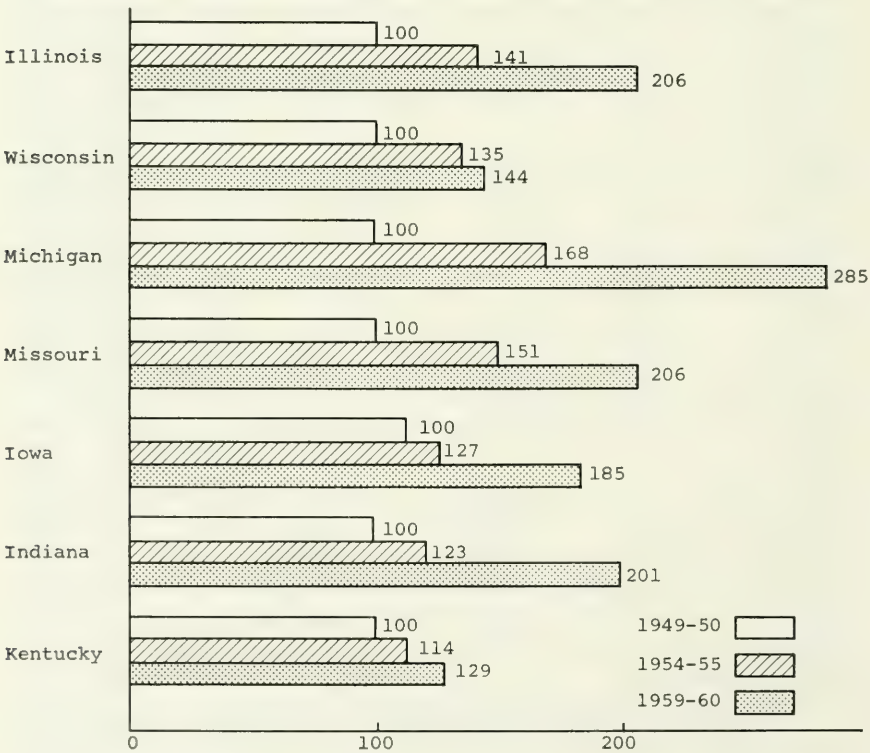
Let us now examine the possible effects of the various types of shifting taxes on Illinois farm real estate under current conditions. Forward shifting

in the form of higher prices for farm products does not seem to be possible under existing circumstances. Even though taxes may have forced some marginal land out of production, the restrictive effects on the supply of farm products have been more than offset by yield increases due to non-land inputs. The result has been a persistent increase in supply relative to demand. Thus farmers have been unable to raise or even to maintain prices.

Shifting the tax to labor in the form of lower wages to hired labor also appears impossible. Farm wage rates have risen more rapidly than prices of most other farm inputs in the post-World War II period, and yet they are generally considered to be lower than wage rates in other industries. Attempts to lower farm wage rates would probably further restrict the supply of hired farm labor. Owner-operators have continued to buy farmland at increasing prices, indicating some tendency to accept either lower returns to labor if land and nonland inputs are paid their full share of the returns, or lower returns to these inputs if labor is paid at going farm wage

CHART 3

Comparisons of Trends in Farm Real Estate Taxes per $1,000 Net Farm Incomes, Selected States, 1949-60 (Index Based Upon 1949-50=100).



rates. Tenant operators seem to have been able to resist increases in rents to a large extent and thus have prevented landlords from shifting their real estate taxes in this way. The reason may be that farm rents tend to be determinated by customs that are slow to change in comparison with changes in the economic situation.

Some industries are able to shift taxes backward to suppliers of raw materials. This type of shifting appears less likely in agriculture than in other industries because of the larger number and smaller size of farm businesses than of farm supply businesses. Although individual farmers are sometimes able to bargain with individual dealers to obtain lower prices on such items as machinery or fertilizer, most farmers are "price-takers" rather than "price-makers." They are thus not able to lower other costs to compensate for higher property taxes. Farmers can and do, however, form cooperatives to become their own suppliers.

Capitalization of farm real estate taxes certainly does not seem feasible in view of, among other things, the almost parallel increase in land values and taxes in recent years. Yet it can be argued that land values would be even higher if property taxes were lower. So the increase in land values in the face of rising land taxes in a relatively short period does not refute the theory of tax capitalization. Some of the conditions necessary for capitalization of the tax exist only imperfectly, if at all, in the present situation. Because of the relatively small number of sales of land, opportunity for capitalization is present on only a small proportion of all farm real estate. Prospective buyers are generally aware of the present high level of taxes, but it is not likely that they can predict the future pattern of change. It is doubtful whether many buyers in the early 1950s anticipated the rapid increases in their tax bills that have occurred during the past decade. Finally, the overwhelming majority of buyers are themselves farmers, whose investment alternatives are limited in comparison with those of nonfarm buyers, and who are willing to pay a high price for additional land to add to existing farms. Thus, much of the tax that is capitalized remains in the agricultural sector of the economy.

The apparent conclusion is that owners of farm real estate bear the major portion of farm real estate taxes, with little opportunity for shifting them. This does not mean that in Illinois farmers bear most of the taxes. Because of the high proportion of rented land in the State, nonfarm landlords bear a substantial portion of these taxes. Data from the 1959 Census of Agriculture indicate that 59 percent of the farmland is rented. In the cash-grain area of east-central Illinois, an area of high land values and correspondingly high taxes, the proportion is 72 percent. Approximately one-third of the rented land is owned by either active or retired farmers and rented to other farmers, but much of it is in the hands of nonfarm landlords, who consequently bear a high proportion of the total farm real estate tax load.

CHAPTER XIV

STATE EQUALIZATION OF LOCAL ASSESSMENTS

By H. K. Allen*

Notwithstanding the fact that assessment of property at its full, fair, cash value has been a statutory requirement since 1927, debasement of assessments has been a common practice. Taxpayers desire low assessments, because they think that low assessments assure low taxes. They forget that the assessment is just one factor in the determination of the tax bill and that if assessments are universally low, tax rates, except as limited by statutory maxima, will be correspondingly high. Thus a property owner can profit from a debased assessment only when his property is assessed at a lower level than that generally prevailing in the district. The elective system for local assessors has also probably contributed to the debasement of assessments. It provides a temptation for assessors to curry favor with their constituents by giving them low assessments.

Assuming uniform debasement, the major objection to the practice is that errors are more likely to occur when a debased standard is used than in the case when the standard is full market value. Errors in debased assessments are less conspicuous than they are when the assessments are on a full value basis.

Not only has debasement been a long-standing practice in Illinois, but the general levels of assessment have varied widely among the various counties throughout the State. In 1945 when the present state equalization of assessments program was adopted (to become effective January 1, 1946) the ratios of assessed to full value, as computed by the Department of Revenue, ranged from 14 percent in White County to 68 percent in Cook County.[1] The State-wide average in 1945 was 46 percent, whereas the average for downstate was 27 percent.

The statute which set up the State equalization program makes it the responsibility of the State Department of Revenue to adjust the total assessed value of property in each county to its full, fair, cash value.[2] The law provides that the Department shall determine the ratio of the assessed valuation of locally-assessed property to full value in each county. The general method used by the Department in computing the assessment ratios is explained in *Tax-Rate Limits and Assessment Ratios,* published by the Illinois Tax Commission in 1940. Under the plan used, studies are made on a properly weighted basis of the ratios of assessed valuations to selling prices of real estate actually sold during the first three years of the four-year

*In the preparation of this report, the author received helpful suggestions and criticisms from Eugene L. Maynard and Allan E. Garber, Property Tax Division, Department of Revenue.

[1] *Report of the Revenue Laws Commission,* State of Illinois, pp. 57-58, 1949.

[2] A statute adopted in 1957 requires Boards of Review to equalize assessments among townships or other local assessments districts within the county, but there has been no extensive equalization activity under this law.

period next preceding the subject year. Upon the basis of this information the Department certifies to each county clerk the percentage by which he shall increase or decrease the total assessed valuation of locally-assessed property. It is the duty of the county clerk to use the assessed valuation which results from the application of this percentage for purposes of computing tax rates and extending taxes. For the convenience of the county clerks in performing their duty, the Department computes a "multiplier" which is the reciprocal of the county-wide assessment ratio.

Under the original law the Department of Revenue was required to certify multipliers annually. Legislation adopted in 1959, however, provided that certification of multipliers would be restricted to the year in which there is a quadrennial assessment. It further provided that the next real estate quadrennial assessment year in downstate counties would be 1963, and each fourth year thereafter, except Cook County which is to be divided into four assessment districts, Capital Township, Springfield and City Township, Peoria, each district to have a quadrennial assessment year. Legislation adopted in 1961 provided that the next quadrennial assessment year in counties under the commission form of government would be 1962 and each fourth year thereafter.

To the extent that the assessment-sales ratios reflect the actual level of assessments, application of the multipliers converts the level in each county to a uniform state-wide level which, if the requirements of the statute are met, is full value.

It should be emphasized at this point that the state equalization program does not eliminate inequalities in the original assessment of individual properties. It pertains to county-wide assessment ratios—not to individual assessments. Uniformity in individual assessments can only be attained by marked improvement, along the lines suggested previously, in the administration of such assessments.

Advantages of State Equalization Program. Nothwithstanding serious shortcomings in equalization machinery and procedures, adoption of the program was a highly constructive step. In the first place, attainment of a more uniform level of assessment among the various counties throughout the State has done much to equalize tax burdens in districts that overlap county boundaries.[3] Secondly, a more uniform state-wide level of assessments has the advantage that it renders tax-rate and debt limits more uniformly applicable among the various counties. These limits are customarily expressed in amounts per $100 of assessed valuation. Before the adoption of the full-value assessment program, taxing units in counties with relatively high assessment ratios had higher "effective" tax-rate limits and debt limits than those in low assessment counties. Assessment levels could be manipulated to avoid the limits thereby thwarting the purpose of such limits.

[3] For a detailed explanation, see the *Report of the Revenue Laws Commission*, pp. 59-60, 1949.

A third advantage of the equalization program is that it renders more uniform the application of the tax-rate factor among local units in qualifying for State aid. The minimum qualifying rates for equalization aid to schools and for grants to local units for general assistance are expressed in terms of assessed valuation. As a result of the marked variation in assessment ratios among the various counties "effective" qualifying rates varied widely before 1946. In general, assessment ratios in the wealthy counties were lower than those in the less wealthy counties. Consequently, school districts in many of the wealthy counties were able to qualify for equalization aid with relatively low "effective" tax rates. To the extent that this condition existed, the objectives of equalization aid was not realized.

A fourth advantage of the equalization program is that it provides a means whereby tax burdens can be equalized between State-assessed and locally-assessed property. It will be remembered that railroad property and the capital stock (corporate excess) of certain classes of domestic corporations are assessed by the State Department of Revenue. Before 1946, when the present equalization program became effective, the assessments of State-assessed property were certified back to the counties at the State-wide average. As a result, the tax burden in counties with assessment ratios lower than the State-wide average was relatively less upon locally-assessed property than upon State-assessed property. The converse was true in counties with assessment ratios higher than the State-wide average. That this advantage has not been fully realized in recent years is evidenced by Supreme Court decisions which held that railroad property was assessed at full value whereas locally-assessed property was equalized at a level substantially below full value. This problem will be discussed later in this chapter.

In addition to the foregoing advantages, considerable evidence supports the view that the equalization program has been a significant factor in improving the quality of the original assessments at the local level. That the equalization program has provided an incentive for local assessors to assess property at the State-wide standard in the first instance is indicated by changes in county multipliers between 1948 and 1958, shown in Table 1. In 1948, only 6 counties had a multiplier of less than 1.5; only 2 counties had a multiplier of less than 1.2; and only 1 county—Kane—had a multiplier of one. In 1958, 77 counties had a multiplier of less than 1.5; 61 counties had a multiplier below 1.2; and 37 counties had a multiplier of one. That a marked improvement occurred is apparent.

The reduction through the local assessment process of the disparity in the levels of assessments among the various counties has been accompanied by a reduction in the deviation of individual assessments from uniformity within many of the counties. Table 2 shows the coefficients of dispersion for both urban and rural property in each of the 102 counties in 1948 and 1958.

TABLE 1

County Multipliers

County	1948	1958*	County	1948	1958*
Adams	2.5000	3.2258	Jefferson	5.5555	1.0000
Alexander	2.2727	2.7777	Jersey	3.1250	4.0000
Bond	2.6315	1.0000	Jo Daviess	2.5000	1.0000
Boone	2.5641	1.0000	Johnson	2.5641	3.0303
Brown	2.2222	2.5000	Kane	1.0000	1.0526
Bureau	1.2500	1.0000	Kankakee	4.5455	1.0000
Calhoun	1.6949	1.1765	Kendall	4.0000	1.1111
Carroll	1.0204	1.0870	Knox	1.8571	1.0000
Cass	2.4390	1.3541	Lake	——	1.0000
Champaign	5.2632	1.0000	LaSalle	3.8461	1.0000
Christian	3.2258	1.0000	Lawrence	4.5455	1.1236
Clark	4.5455	1.1236	Lee	3.3333	1.2987
Clay	3.5714	1.1905	Livingston	2.0000	1.0870
Clinton	2.7027	3.5714	Logan	3.0303	1.0753
Coles	5.0000	1.0000	McDonough	3.5714	1.0000
Cook	1.4286	1.4500	McHenry	4.1667	1.0000
Crawford	6.6667	1.9526	McLean	4.3478	1.0000
Cumberland	5.0000	1.2987	Macon	4.5455	1.1494
DeKalb	3.3333	1.1494	Macoupin	4.3478	1.0000
DeWitt	4.1667	1.1765	Madison	5.8824	1.0000
Douglas	4.1667	1.0000	Marion	3.7037	1.0000
DuPage	——	1.0000	Marshall	3.7037	2.2222
Edgar	5.0000	1.0000	Mason	2.7027	1.4085
Edwards	3.0303	1.0000	Massac	2.1277	2.8571
Effingham	3.3333	4.1667	Menard	2.2222	2.7777
Fayette	3.5714	1.1905	Mercer	3.0303	1.0000
Ford	4.1667	1.0000	Monroe	2.1277	2.2727
Franklin	6.2500	1.2195	Montgomery	1.0870	1.0000
Fulton	3.3333	1.0000	Morgan	2.6316	1.3158
Gallatin	4.0000	4.5455	Moultrie	4.0000	1.0000
Greene	2.4390	1.0000	Ogle	3.4483	1.0000
Grundy	4.3478	1.2048	Peoria	4.3478	1.0000
Hamilton	7.1429	1.1236	Perry	2.6315	1.2195
Hancock	2.9412	1.0000	Piatt	4.7619	1.0000
Hardin	4.5455	1.1236	Pike	4.7619	2.0000
Henderson	2.8571	1.1236	Pope	2.2727	1.0526
Henry	3.0303	1.2195	Pulaski	1.9231	1.2195
Iroquois	3.7037	4.0000	Putnam	3.4483	2.6315
Jackson	3.7037	5.0000	Randolph	3.0303	1.1494
Jasper	4.0000	1.1111	Richland	4.0000	1.0000

TABLE 1 (Continued)

County	1948	1958*	County	1948	1958*
Rock Island ...	4.0000	1.1364	Vermilion	4.0000	1.0000
St. Clair	5.2632	1.4085	Wabash	6.6667	1.4493
Saline	4.0000	6.2500	Warren	3.5714	1.0000
Sangamon	3.0303	5.8824	Washington ...	2.5641	1.0000
Schuyler	2.1739	3.5714	Wayne	4.0000	1.1364
Scott	3.0303	2.8571	White	7.6923	1.1628
Shelby	2.7777	1.3541	Whiteside	3.5714	1.0000
Stark	3.4483	1.4925	Will	5.2632	1.0000
Stephenson	3.2258	1.1765	Williamson	3.8462	4.7619
Tazewell	4.5455	6.6667	Winnebago	5.0000	1.0000
Union	2.7777	1.0000	Woodford	4.3478	1.1111

SOURCE: Property Tax Division, Department of Revenue.
*Because of action by the General Assembly in 1959, multipliers for 1959, 1960 and 1961 are the same as for 1958.

TABLE 2

Coefficients of Dispersion of Property Tax Assessments

County	1948		1958	
	Urban	Rural	Urban	Rural
Adams	30	35	22	20
Alexander	38	39	31	44
Bond	24	27	16	16
Boone	28	20	14	22
Brown	32	30	27	15
Bureau	39	17	12	14
Calhoun	—	—	—	—
Carroll	23	18	16	13
Cass	24	35	20	—
Champaign	26	15	13	16
Christian	35	40	27	17
Clark	34	30	22	19
Clay	30	30	22	26
Clinton	30	34	28	27
Coles	37	35	13	21
Cook	23*	—	18*	—
Crawford	26	40	16	21
Cumberland	29	28	27	28
DeKalb	23	20	18	11
DeWitt	31	22	20	18
Douglas	35	17	14	12
DuPage	18	37	10	—

TABLE 2 (Continued)

County	1948		1958	
	Urban	Rural	Urban	Rural
Edgar	34	29	22	17
Edwards	26	38	13	—
Effingham	29	37	27	32
Fayette	29	23	22	29
Ford	32	18	14	—
Franklin	40	37	20	15
Fulton	34	44	18	16
Gallatin	29	31	28	—
Greene	28	28	23	21
Grundy	38	31	18	19
Hamilton	36	44	17	—
Hancock	31	24	19	15
Hardin	35	39	23	—
Henderson	36	26	25	—
Henry	34	28	19	12
Iroquois	32	21	32	20
Jackson	42	35	25	24
Jasper	32	30	26	17
Jefferson	32	45	16	22
Jersey	28	32	30	15
Jo Daviess	32	23	19	13
Johnson	41	39	17	19
Kane	24	21	12	16
Kankakee	35	30	9	12
Kendall	38	33	17	15
Knox	29	30	11	11
Lake	26	32	14	24
LaSalle	37	28	15	10
Lawrence	28	31	19	23
Lee	28	33	19	27
Livingston	25	14	14	20
Logan	31	24	23	8
McDonough	30	24	16	15
McHenry	35	32	14	18
McLean	25	24	11	12
Macon	20	30	16	11
Macoupin	33	28	23	16
Madison	39	42	13	20
Marion	26	38	14	12
Marshall	34	36	18	—
Mason	37	27	18	26

TABLE 2 (Continued)

County	1948		1958	
	Urban	Rural	Urban	Rural
Massac	36	35	31	—
Menard	37	23	25	16
Mercer	37	30	25	19
Monroe	34	38	13	26
Montgomery	36	24	23	20
Morgan	32	32	15	15
Moultrie	20	30	24	—
Ogle	27	24	17	16
Peoria	37	33	17	14
Perry	31	39	27	17
Piatt	37	26	14	14
Pike	32	35	21	13
Pope	48	45	12	26
Pulaski	26	33	22	29
Putnam	40	16	—	—
Randolph	29	32	20	21
Richland	26	30	14	14
Rock Island	26	29	13	20
St. Clair	27	43	16	26
Saline	39	37	26	25
Sangamon	29	27	25	25
Schuyler	41	28	26	18
Scott	52	42	33	26
Shelby	33	26	18	21
Stark	28	21	12	7
Stephenson	34	25	14	12
Tazewell	39	30	20	27
Union	28	35	15	17
Vermilion	29	21	17	10
Wabash	27	25	19	14
Warren	28	25	18	14
Washington	30	29	10	14
Wayne	38	25	18	19
White	37	37	22	23
Whiteside	31	33	18	19
Will	28	25	14	15
Williamson	35	49	25	33
Winnebago	24	34	9	25
Woodford	32	36	13	11

SOURCE: Property Tax Division, Illinois Department of Revenue
*No urban and rural breakdown is made for Cook County; the figure here is the total county figure which is, of course, largely urban.

In the case of urban property the coefficient of dispersion was lower in 1958 than it was in 1948 in every county except three. The exceptions are Iroquois, Jersey and Moultrie Counties. In the case of Iroquois County no change occurred. Again, in only three counties—Cumberland, Fayette, and Livingston—was the coefficient of dispersion of rural property equal or higher in 1948 than it was in 1958. The figure for Livingston County was the same in both years. The median coefficient of dispersion of urban property in all counties in 1948 was 31.5, whereas the corresponding median in 1958 was 20.5. The median for rural property in 1948 was 30, while it was only 19 in 1958. The median coefficient of dispersion for urban property in counties which had a multiplier of one in 1958 was 15 as compared with a median of 23 in counties which had a multiplier greater than one. In the case of rural property the median for the former group in 1958 was 16 as compared with 21 for the latter group.

Shortcomings of State Equalization. Within the limitations of staff and budget, the Department of Revenue has been doing a good job in computing the assessment-sales ratios, but much greater use should be made of appraisals. In many counties there is a paucity of usable transfers and, in any event, the properties sold consist predominantly of farm land and urban houses. Large industrial, commercial, and public utility properties are seldom sold, yet the assessed values of these properties represent approximately one-fourth of the total assessed value of real property in Illinois. For the purpose of computing assessment ratios, all real estate in each county should be divided into major classes. The assessment ratio of each class should then be determined through the use of sales ratios and appraisals. The assessment ratios of the various classes of real estate should then be properly weighted in computing the county assessment ratios. In formulating a detailed plan to improve the computation of county assessment ratios in Illinois, careful consideration should be given to the procedure used by the New York State Board of Equalization and Assesment in determining state equalization rates.[4]

Although difficult to administer, more extensive use should be made of personal property in computing county assessment ratios. If the number of categories of personal property were drastically reduced, as previously recommended, it should be possible by the use of a sampling technique to compute assessment ratios for the remaining categories. Contrary to a belief widely held, exclusion of personal property does not worsen any disparity that may have existed in the distribution of the tax burden between personalty and realty. If the average assessment ratio in a county is 25 percent for personal property and 50 percent for real estate, application of the appropriate multiplier will not affect the relative distribution of the tax burden between the two classes of property. This fact, of course, does not

---

[4] *Principles and Procedures Used in Establishing State Equalization Rates,* State Board of Equalization and Assessment, New York, 1961.

mean that disparities in assessment levels between personalty and realty are of no consequence.

The freezing by the General Assembly in 1959 of county multipliers in the intervening years between the quadrennial assessment of real estate was a serious backward step that should be corrected at the earliest opportunity. It will be remembered that county multipliers were certified annually before 1959. The argument for quadrennial certification of multipliers is that the multiplier remains the same throughout a four year period. In this way, the equalized assessed valuation, except for additions to or deletions from the roll, remains the same during the quadrennium. This, in turn, provides the tax-levying authorities with a better idea of how much revenue a particular tax rate will produce and thereby facilitates the preparation of budgets and the making of tax levies. A stable multiplier during the quadrennium enables county clerks to begin their work of multiplying original assessments by the multiplier earlier than would otherwise be possible.

Despite the advantage of the quadrennial certification of county multipliers, the annual certification of multipliers is definitely superior. Even with annual certification, reductions can and do occur in assessment levels. This fact is evidenced by the status shown in Table 3 of median assessment ratios of rural property for the years 1954-1957. The year 1954 was the quadrennial reassessment year in counties under township organization. It will be noted that substantial reductions occurred between 1954 and 1957 in the median assessments of the counties listed. With quadrennial certification of multipliers, there is a possibility that boards of review in some counties will reduce the assessment level in the intervening years. To the extent that such a reduction occurs, the next quadrennial multiplier will be correspondingly higher. If the reduction is substantial, the change in the multiplier will be large and the disruption to local budgets and tax levies will be serious.

The local assessment officials in many counties have made an earnest effort to raise the level of assessments in their county to the point where they could receive a multiplier of one. Several counties, as a matter of fact, have qualified for a multiplier of one for several consecutive years. Quadrennial certification of multipliers is likely to dampen the desire of local assessment officials to obtain a multiplier of one, and to make them less vigilant in keeping the level of assessments abreast of changing property values. So far as the disrupting effects of an annual certification of multipliers upon local budgets and tax levies are concerned, such effects can be largely eliminated if local assessment officials (assessors and boards of review) consistently assess property in the first instance at a level which meets the requirement for a multiplier of one. This objective can be attained by well qualified and diligent local assessment officials. It is entirely feasible that property tax assessments can be administered by local assessment officials in such a way that they can be reasonably certain that a multiplier

of one will be certified by the Department of Revenue. It appears from a study of median assessment ratios that the Department of Revenue has been liberal in certifying a multiplier of one when the level of assessments in a county is reasonably close to the standard required. By qualifying for a multiplier of one, the expense of the equalization computations in the county clerk's office can be avoided—X x 1 = X. As previously suggested, the weight of the argument is definitely in favor of annual certification of county multipliers.

TABLE 3

Median Assessment Ratios of Rural Property in Selected Illinois Counties, 1954-1957

County	1954*	1955	1956	1957
Christian	50	50	44	42
Clay	54	50	45	42
Crawford	64	58	55	53
Grundy	51	44	42	42
Jo Daviess	58	57	56	45
Lee	45	42	39	37
Macoupin	45	42	36	37
Perry	58	43	46	41
Shelby	43	36	38	34
Vermilion	50	43	39	39
Warren	48	32	48	38

SOURCE: Property Tax Division, Department of Revenue.
*Quadrennial reassessment year in township counties; all counties included in the table, except Perry, have the township form of government.

Although the local assessment officials in most Illinois counties have made a serious effort to raise the level of assessments, 22 counties received multipliers greater than 2.0 in 1958. These counties were assessing property at less than half the standard required for a multiplier of one. This condition is, of course, not a defect in the equalization program *per se*, but it is rather a shortcoming in the performance of local assessment officials. The level of assessments in these counties and in all others that do not have a multiplier of one should be raised to the statewide standard.

A serious problem has arisen recently as a result of decisions of the Supreme Court of Illinois, which has sustained tax objections filed by railroads in Sangamon and Lee Counties on the ground that railroad property assessed by the Department of Revenue was assessed at full value whereas locally-assessed property was assessed substantially below full value.[5]

[5] *People Ex Rel. Hillison* v. *Chicago Burlington and Quincy Railroad Company*, 22 Ill. 2d 88 (1961). This case originated in Lee County. *People Ex Rel. Kohorst* v. *Gulf Mobile and Ohio Railroad Company and People Ex Rel. Kohorst* v. *Chicago and Northwestern Railroad Company*, 22 Ill. 2d 104 (1961). These cases originated in Sangamon County.

Until recently, the Department of Revenue never officially disclosed the standard used in computing county multipliers. The Department did, however, make available information on ratios of assessed value to full, fair, cash value of property in Illinois for use in the railroad tax objection case in Lee County. These ratios for the years 1946 to 1957 are as follows:[6]

1957	48.10%	1951	52.62%
1956	47.74%	1950	56.78%
1955	49.79%	1949	62.18%
1954	49.80%	1948	63.20%
1953	51.28%	1947	64.00%
1952	51.32%	1946	74.48%

From these ratios and the county multipliers certified for the same years, it is evident that the standard for computing county multipliers has not been full, fair, cash value at any time since the program became effective in 1946. Not only has the standard been substantially less than 100 percent of full, fair, cash value, but it has been steadily lowered since the inception of the program. That the recent level of equalized assessed valuation of locally-assessed property has been substantially below full value was confirmed by the Supreme Court in the railroad tax objection cases in Lee and Sangamon Counties.

In the Lee County tax objection case, the Chicago, Burlington and Quincy Railway Company claimed a refund of 45 percent of its property taxes for the year 1958 on the ground that railway property was assessed at full value while locally-assessed property was assessed at 55 percent of full value. Although the case pertained directly to the level of assessments in Lee County, "The trial court found not only that the ratio of equalized assessed value to full, fair, cash value of locally assessed property in Lee County did not exceed 55 percent for the year 1958, but also that such ratios in the State as a whole did not exceed 55 percent." The Supreme Court affirmed the decision of the trial court and sustained the railroad's objections. It will be noted that the Court in this case did not specify the precise level of assessments, but stated rather that it did not exceed 55 percent.

In the Sangamon County case, which involved similar tax objections by the Gulf, Mobile, and Ohio Railway Company and the Chicago and Northwestern Railway Company to their 1957 taxes, the Supreme Court found that the level of assessments of locally-assessed property in Sangamon County was "just under 50 percent of its full, fair , cash value."

The Supreme Court was not influenced in either the Lee County or the Sangamon County cases by the fact brought out in the trial court that the Department of Revenue applied a "judgment" factor to the sum derived from the application of the statutory three-factor formula to compute the

[6] Derived from Exhibit 21, James R. Parham, "Taxation of Property in Illinois," *Law Forum*, University of Illinois, Vol. 1961, No. 4, p. 649. This article contains an excellent discussion of the recent railroad tax cases in Lee and Sangamon Counties.

assessed valuation of the railroads.[7] The three factors prescribed by law (statute does not specify weights to be given to the three factors) are the capitalized value of the company's earnings; the market value of its stock and debt; and the reproduction cost of its physical property less depreciation. To this sum, the Department is authorized to apply a judgment factor in arriving at a final assessment, which presumably is full, fair, cash value. In the Lee County case, the fact was disclosed that the judgment factor was 73 percent. In other words, the final assessment for the Chicago, Burlington, and Quincy Railway Company in Lee County in 1958 was 73 percent of the sum derived from the application of the three-factor formula. The Supreme Court apparently assumed that application of the 73 percent judgment factor was proper in arriving at full, fair, cash value. The Court may have been influenced in this view by the testimony of Mr. Raymond S. Danis, railroad assessor of the Department in 1958, that the final assessment of the railroad, in his opinion, was on a full, fair, cash value basis.

Some idea as to the standard used recently in computing county multipliers can be obtained from a study of median assessment ratios of counties which had a multiplier of one in 1958.[8] The median assessment ratios of such counties are shown in Table 4. It is not intended to imply that county multipliers in 1958 were derived from the median assessment ratios for that year. In accordance with the procedure previously explained, county multipliers in 1958 were based in general upon the assessment-sales ratios for 1954, 1955, and 1956.

In the case of rural property, the statistics show a concentration of median assessment ratios in the 42 to 51 range. The spread for urban property is somewhat greater, with concentration in the 43 to 53 range.

The foregoing facts suggest that the Department of Revenue has recently been using a standard, with considerable flexiblity in application, of approximately 50 percent of full, fair, cash value in computing county multipliers.

Information is not available as to the reasons why the Department of Revenue, according to findings of the Supreme Court, has been assessing railroad property at full, fair, cash value while, contrary to the injunction of the Constitution and the statute, it has been equalizing locally-assessed property at a level substantially below full value. In the opinion of the writer, the debasement of the standard used in equalizing locally-assessed property has resulted primarily from strong outside pressures. Blame for the situation lies largely with the prevailing form of administrative organization for state equalization and assessments which, because of its political orien-

---

[7] The judgment factors for most of the railroads in 1961 were in the 65 to 75 percent range. This information was obtained from an Exhibit filed in March, 1962, in the Gulf, Mobile and Ohio Railway Company tax objection case in Grundy County, Illinois.

[8] Because of the fact that the General Assembly froze the multipliers in 1959, the multipliers for 1958 will remain unchanged in counties under the township form of government, except Cook County, until the next quadrennial reassessment of real estate in 1963. Counties under the commission form of government (17) are subject to changes in multipliers in 1962—the quadrennial reassessment year in such counties.

TABLE 4

Median Assessment Ratios of Rural and Urban Property In 37 Counties Which Had a Multiplier of One in 1958

Median Assessment Ratio	Rural*	Urban
57	1	1
56	—	2
55	—	—
54	—	2
53	—	3
52	—	5
51	4	—
50	1	3
49	3	2
48	5	4
47	5	3
46	2	4
45	3	—
44	5	1
43	3	3
42	2	1
41	—	1
40	—	—
39	—	—
38	—	1
37	—	1

SOURCE: Property Tax Division, Department of Revenue.
*Median assessment ratios for rural property were not available for three counties.

tation, is especially vulnerable to outside pressures. No criticism of the personnel of the Department of Revenue is intended. The Department has on its staff many highly competent and dedicated individuals. The incumbent Director of Revenue has "inherited" the present situation from his predecessors.

Suggested Reforms. In order that the State functions of equalization and assessment may be insulated to the fullest possible degree against outside pressures and to provide continuity of direction, it is proposed that these functions be transferred from the Department of Revenue to a new three-member State Board of Equalization and Assessment. Members of the proposed new board should be appointed by the Governor for a six-year term with the initial appointments staggered so that one member will be appointed every two years. Confirmation of appointments by the Senate should be required and it should be provided by law that not more than two members of the board can be members of the same political party.

Persons appointed to the board should be individuals with outstanding knowledge and experience in property valuation.

Within the strict framework of the law, it would be the duty of the proposed new board to formulate policies, establish and supervise procedures, and certify assessments and equalization factors. Since the bulk of the actual work would be done by the technical and clerical staff, membership on the Board would not be a full-time appointment. For this reason and because better qualified persons can often be obtained for special high-level assignments in government service on a nonsalaried basis, it is proposed that members of the Board not be compensated for their services. It is assumed, of course, that they would be reimbursed for necessary expenses.

Subject to the provisions of the "Personnel Code," the Board should be authorized to obtain a full-time, salaried Secretary who would be charged with the responsibility, under the general supervision of the Board, to direct the day-to-day activities of assessment and equalization. The Secretary should be selected on the basis of outstanding ability, without regard to state of residence, and the salary should be high enough to attract an outstanding person.

Adoption of the proposed plan would enable the Department of Revenue to allocate all of its resources to the formidable task of tax collection. Unlike many types of administrative reorganization, the proposed plan could be put into effect without a large financial outlay. Improvement of the procedures used in computing county equalization factors and the assesment of all corporation property by the proposed new board, both of which were previously recommended, would obviously increase costs at the State level.

Establishment of a State Board of Equalization and Assessment would not in itself solve the current problem of railroad valuation objections. As previously indicated litigation of railroad valuation objections will continue until railroad property is assessed at the same percentage of full, fair, cash value as is locally-assessed property.

Since tax rate limits, debt limits, and tax levies of local governmental units are adjusted to the current debased level of equalized assessed valuations, it would be impracticable to equalize assessments of locally-assessed property on a full value basis. The entire history of the general property tax in Illinois and elsewhere, moreover, has demonstrated beyond any question of doubt that public sentiment is strongly opposed to full value assessments. In view of these facts, two possible courses of action are available.

One of the possible solutions to railroad valuation objections would be for the State agency charged with the responsibility for railroad assessments to compute the full, fair, cash value of railroad property in accordance with the statutory formula, and then debase the valuation thus determined in accordance with the standard used in computing county multipliers. If

locally-assessed property were equalized at 50 percent of full, fair, cash value, railroad property under this procedure would be assessed at the same percentage of full value. The objection to this approach is that under existing law it would be illegal to debase the full-value assessment of railroad property. That locally-assessed property, contrary to law, is equalized at less than full value does not warrant assessment of railroad property at less than full value.

The only practicable solution to the problem of railroad valuations and other problems related to the debasement of locally-assessed property is to change the law to provide that all locally-assessed and state-assessed property shall be assessed and equalized at 50 percent or 55 percent of full, fair, cash value. A bill (H. B. 843) was introduced in the 1961 session of the General Assembly which provided for an assessment level at 55 percent, but it was not adopted. Adoption of an assessment level of 50 or 55 percent would make legal a situation which exists in fact, and hence would not significantly affect "effective" tax rate limits, debt limits, and qualifying rates for State aid. Most of these limits are expressed in terms of a specific percentage of the full, fair, cash value, as equalized or assessed by the Department of Revenue, of the taxable property within the taxing district. The meaning of the term "effective" tax rate limit, can be explained by an example. If locally-assessed property is equalized at 50 percent of its full, fair, cash value and the statutory maximum tax rate limit of a particular taxing district is 60 cents on each $100 of equalized assessed valuation, then the "effective" tax rate limit of the district is 30 cents. Reduction of the statutory standard from full value to 50 or 55 percent of full value would not in itself require adjustments in tax rate limits, debt limits, and qualifying rates.

CHAPTER XV

PROPERTY TAX RATE LIMITS

By Irving Howards*

Introduction

An examination of the amount of taxes raised locally demonstrates clearly that the property tax, although declining somewhat as the major source of local revenue in Illinois, still constitutes for Illinois local governments the primary source of revenue. Thus one can note that local property taxes in 1957 amount to 86% of all local tax revenue, only a 5% decline since 1942.[1] Counties still obtain about 97% of their local tax revenue from the property tax while townships, school districts and special districts receive all of their local revenue from this source.[2] Only the municipality which derives about 55% of its local revenue from property tax because of its ability to levy a variety of local taxes has escaped this overwhelming dependence upon the property tax.[3] Therefore, it is entirely logical to state that limitation upon the ability of the county, the township, and to a lesser extent the municipality to use the property tax is a matter of primary concern to both local and State officials dealing with problems of revenue.

Restrictions on the Use of the Property Tax

The property tax has historically been subject to a variety of statutory, administrative, and constitutional limitations affecting the total amount of revenue which could be obtained from this source. In 1871 when the property tax was still a major source of revenue for the state, the Illinois General Assembly authorized a tax upon the capital stock of corporations. The productiveness of the tax for the state was limited when the Illinois Supreme Court ruled that it could be applied to domestic corporations only and when the General Assembly divided responsibility for assessing capital stock between state and local assessors. Local governments have not received significant additional revenues from this tax source however since "many local assessors make little if any attempt to assess the capital stock of these corporations . . ."[4]

Similarly intangible personal property escapes taxation. "In Cook County a de facto classification system permits the listing of bank deposits at 4% and stocks and bonds at 10% . . . Downstate . . . only a small frac-

---

*The author is Associate Professor in the Department of Government and Public Affairs Research Bureau, Southern Illinois University. Helpful suggestions and criticisms were received from Eugene L. Maynard and Allan E. Garber, Property Tax Division, Department of Revenue, in the preparation of this report.

[1] *Government in Illinois*, 1957 Census (Washington: U. S. Department of Commerce, Bureau of the Census), Table 23, p. 14. *State and Local Finances in 1942 and 1957* (Washington: U. S. Department of Commerce, Bureau of the Census), Table 7, p. 23.

[2] The addition of the "sales tax" for counties probably diminishes to a moderate extent county dependency upon the property tax as a source of local revenue.

[3] *Government in Illinois*, *op. cit.*, Table 23, p. 14.

[4] Glenn W. Fisher, "An Economist's Appraisal of the Illinois Tax System," *Illinois Law Forum* (Vol. 1961), p. 577.

tion . . . is assessed in any county."[5] And of course assessment of other personal property is notorious by its absence.

Assessment of real estate is also subject to the judgments of the local assessors. Even the program of state equalization of property taxes authorized by the 1945 General Assembly has been unable to eliminate the variances inherent in local assessing.[6]

Since the 1870 Constitution, counties have been subject to the provisions of Article IX Section 8 limiting the total rates which may be levied by the county to 75 cents on each $100 of equalized assessed valuation except if an increase is permitted by local election. But among the most controversial restrictions placed upon the prerogatives of local governments to use the property tax are the detailed statutory rate limits placed on the various funds utilized by the county, the municipality and the township. Their meaning, their effect upon the revenue producing abilities of local governments as measured by the property tax; and their implications upon state-local fiscal relations have been points of dispute in Illinois. It is to these questions that this paper is directed.

The Purpose of Tax Rate Limits

The use of the property tax rate limit has been the subject of considerable debate.[7] Those who support property tax rate limits suggest that:

1. By limiting the amount of revenue which can be obtained from the property tax the local government is forced to seek other sources of non-property revenue thereby lessening the tax load on the beleaguered property taxpayer.
2. Lower rate limits can be an inducement to attract industry into a community.
3. The use of tax rate limitations will mean that the local governmental unit will have to take a new look at the various services it provides in order to determine whether they should be offered locally or by the state with its broader tax base.
4. The use of tax rate limitations can mean that there will be an enlargement of state aid in order to provide adequate finances for the services provided locally.
5. The limited amount of property tax revenue available because of rate limits will force local governments to be more exacting in their budget practices.
6. A limitation of particular funds by the state legislature will ulti-

[5] *Ibid.*, p. 577.

[6] *Taxable Property Values In the U. S.*, (Washington: U. S. Department of Commerce, Bureau of Census) Table 22, p. 133 and Glenn Fischer, *op. cit.*, p. 579.

[7] For example, note, Neil Jacoby, "Control of Local Revenue, Property Tax Rates and Levies," *State-Local Fiscal Relations in Illinois*, Simon E. Leland, Editor (University of Chicago Press: Social Science Studies No. 38, 1941), p. 307; Glen Leet and Robert Paige, Editors, *Property Tax Limitation Laws* (Chicago: Public Administration Service Publication 36, 1936); Vernon Morrison, "Property Tax Limitations," *Report of the Revenue Laws Commission of the State of Illinois* (Springfield: 1949); and more recently C. Ward Macy, "Property Tax Limitations Re-Examined," National Tax Administration, *Proceedings of the Fifty-fourth Annual Conference*, 1961.

mately aid in providing greater uniformity in the various services offered.

7. The limitation on property tax revenue in combination with the demands of competing local governments for the tax dollar will ultimately hasten the simplification and reduction of local governments.

On the other hand those who oppose the rate limit as a revenue control device suggest that:

1. The history of tax rate limit legislation clearly demonstrates that so many exceptions and outright violations to the limits occur that the limits are really ineffective.
2. Whenever a governmental unit does adopt a non-property tax to supplement its property tax revenue, one has great difficulty establishing whether such adoptions were a natural development in taxing powers or a result of the tax rate limitations.
3. There is disagreement over whether new sources of local revenue, usually regressive in nature, lessen the tax load on the majority of property taxpayers, the owners of single family dwellings.
4. There must be some doubt that the transfer of local government services to the state is a desirable trend not only because of the added costs for the state but because of the implications in terms of local government autonomy.
5. Although additional subsidization by the state may be welcome locally the added expense to the state may place a serious drain on the state's fiscal resources.
6. The entire tax rate limit concept implies state control over a very fundamental local government prerogative—local budget-making.
7. There is no evidence to suggest that local government reorganization where it has occurred, it related to the existence of tax rate limits.
8. The major contention of property tax rate limitations is that they benefit the property taxpayer. In short, there is an implicit assumption that owners pay all of the taxes levied against their property. While taxes on owner-occupied homes are not easily shifted, levies on income producing properties "are costs which . . . enter into the pricing process and are shifted to the consumers . . . it is apparent (then) that the ultimate beneficiaries of property tax limitations are difficult to determine, a circumstance which weakens the case of those who contend that property owners are the parties who should be given tax relief and that limitations on property taxes will accomplish this objective."[8]

---

[8] C. Ward Macy, *op. cit.*, p. 483.

Types of Rate Limits

Although the types of rate limits are numerous[9] their use throughout the country has generally fallen into three broad categories:[10] (1) over-all property tax limits restricting the aggregate rates of all local governments to a certain amount prescribed in the state constitution or by statute—Michigan, Nevada, Ohio, Oklahoma and Washington have such over-all rate limits in their constitutions while Indiana, New Mexico, Rhode Island and West Virginia make similar provisions by statute;[11] (2) specific constitutional or statutory limits restricting rates of certain funds of a governmental unit or limiting the total rate which can be levied by a particular type of local government—Alabama, Arizona, Arkansas, Florida, Illinois, Kentucky, Louisiana, Missouri, New York, Texas and Wyoming have such limits in their constitutions while Georgia, Idaho, Iowa, Kansas, Minnesota, Mississippi, Montana, Nebraska, North Carolina, North Dakota, Pennsylvania, South Carolina, Utah and Wisconsin have similar provisions by statute; (3) a relatively recent development, rate limits restricting increases in levies to a percentage of those which prevailed in the previous year except in the case where local election provides additional changes—Colorado and Oregon make such provisions.[12]

Historical Development of Tax Rate Limits in Illinois

It is commonly noted that the major emphasis upon tax rate limits "arose as a consequence of what was regarded as an excessive taxation of property following the collapse of real estate values after 1926 and the general depression of 1929."[13] Yet in Illinois some of the most severe rate limitations preceded and followed this era.

Rate Limits 1849-1900

As early as 1849 and 1851 township highway commissioners were limited to a levy of 20 cents per $100. In 1857 the highway commissioners were authorized a 40 cent per $100 tax with the approval of the electors at the town meeting—in 1867 the highway commissioner was given the authority to make this levy without authorization from the township voters. The county was subject to limitations in 1853 when the county boards of supervisors were restricted to a four mill tax for county purposes. The Constitution of 1848 contained no provisions restricting local rates although as previously noted the present Illinois constitution does limit the aggregate rate of the county to 75 cents per $100 of equalized assessed valuation unless changed by local referendum.

The 1898 Revenue Act provided severe limitations for counties in excess of 125,000 population (Cook County) by requiring that no govern-

---

[9] See Rodney L. Mott and W. O. Suiter, "The Types and Extent of Existing Tax Limitations," *Property Tax Limitation Laws* (Chicago: Public Administrative Service, 1936), pp. 41-45 and Vernon Morrison, *op. cit.*, pp. 120-121.

[10] Eugene A. Meyers, "Permissive Local Taxes: A Review and a Forecast," *Proceedings of the Fifty-Third Annual Conference*, (National Tax Association, 1960), pp. 434-435.

[11] For an interesting commentary on the effect of the Washington limitation see C. Ward Macy, *op. cit.*, pp. 495-496.

[12] See C. Ward Macy, *op. cit.*, pp. 493-494 for an analysis of the Oregon system in operation.

[13] Neil H. Jacoby, *op. cit.*, p. 291.

mental unit in such a county could levy rates whose total exceeded 50 mills. In the event a governmental unit exceeded this amount the county clerk was required to reduce the aggregate to 50 mills "by making a pro-rata reduction in each levy imposed within that aggregate rate . . ."[14] However, in 1900 the Illinois Supreme Court declared the act unconstitutional on the grounds that the practical application of the statute to only one county constituted special legislation.[15]

Rate Limits 1901-1933

Apparently as a means of circumventing the court decision the Illinois General Assembly on May 9, 1901 approved "An Act Concerning the Levy and Extension of Taxes," or as it is more commonly known, the Juul Law.[16] This act was the "first state-wide over-all tax rate limit law, and probably one of the earliest in the United States . . ."[17]

Essentially the act again provided for a 50 mill limit, but this time the restriction was placed on each governmental unit within the state. In the event a taxing district exceeded the 50 mill limitation the county clerk, as in the 1898 Revenue Act, had the authority to scale the rates pro rata among the various funds of the governmental unit involved.

The Juul Act from its very inception was subject to erosion. Thus the original act required that the county clerk, in case a governmental unit exceeded the 50 mill limitation, scale all rates pro rata **except** the following: "State, village, levee, road and bridge, bonded indebtedness in cities wherein such indebtedness exceeded ten percent of the assessed valuation . . . taxes based upon the mandate or judgment of any court of record on any bonded indebtedness, school building taxes, and (except in cities with 100,000 inhabitants) district, high and all other school taxes."[18] And these exceptions were followed by amendments to the Act in 1905, 1909, 1912, 1913, 1915, 1917, 1919, 1921, 1923, 1925, 1927, 1929, 1930, 1931, and 1933 which excluded additional rates from scaling or limiting the amount of scaling. By 1929 the act "was restricted to taxing districts having a population of over 200,000 or in practice, to a few districts in Cook County . . . Thus, the Illinois experience with over-all tax rate limitation . . . proved nugatory . . . (and) created for many years enormous confusion and litigation . . ."[19]

Rate Limits 1933-1945

The abandonment of statutory efforts to limit the over-all tax rates of local governmental units did not mean a corresponding abandonment of the rate limit concept. It did mean, however, that efforts to restrict the use of the property tax returned to the methods prevalent between 1849 and 1900, i.e., rate limitations on specific funds of local governmental units. Early in

---

[14] *Ibid.*, p. 292.
[15] *People* v. *Knopf*, 183 Ill. 410 (1900); *Knopf* v. *People*, 185 Ill. 20 (1900).
[16] *Laws of Illinois*, 1901, p. 272.
[17] Neil Jacoby, *op. cit.*, p. 292.
[18] Harland C. Stockwell, "How Tax Limits Operated in Illinois," *Property Tax Limitation Laws*, *op. cit.*, p. 49.
[19] Neil Jacoby, *op. cit.*, p. 293.

this period it was determined that of the 85 potential levies available to local governments outside of Cook County 74 were restricted by specific tax rate limits.[20] The 1949 Illinois Revenue Laws Commission in commenting upon the complexity and great variety of specific rate limits existing in 1940 noted that:

> The statutory limits on county property tax rates . . . (include) those for the corporate fund, assessment maps or plats, blind relief, burial grounds for soldiers and sailors, county fair, county highway, special road, detention home, employee's pensions, library, mothers' pensions, poor relief (in commission counties only), and tuberculosis sanitarium. No such limits were set on some fourteen provisions for bond and interest levies. Cook County was treated in similar fashion, but was allowed higher limits for the county corporate fund.
>
> Civil townships in 85 counties were not limited on corporate, bond and interest taxes, but were limited for the following purposes: cemetery maintenance, community building maintenance, employees' pensions, library, library building and equipment, park, poor and indigent, public comfort station, road and bridge, hard road and road damage. Road districts in other counties were limited for corporate and three other purposes, but not for bonds and interest.
>
> Various types of school districts had no tax limits on levies for bonds and interest, but were limited as to their educational, building, pensions, tuition, and working cash funds. Districts for park, fire protection and other purposes were also limited for purposes other than bonds and interest.
>
> Various type school districts had no tax limits on levies for bonds and interest, but were limited as to their educational, building, pensions, tuition, and working cash funds. Districts for park, fire protection, and other purposes were also limited for purposes other than bond and interest repayment and service.
>
> For various classes of cities, villages, and incorporated towns outside Chicago the corporate and over forty other permissible levies were subject to tax limitation. Seven of two dozen provisions for bond and interest levies also were limited.
>
> Among the various limited tax levies permitted the City of Chicago in 1940 were five that were pegged—corporate, judgments, library maintenance, municipal tuberculosis sanitarium, and relief of the poor and indigent. The corporate and library maintenance rates could be as high as the law specifically listed, or could be at rates to produce a certain sum of taxes, whichever would be greater. The other levies were limited to total dollar amounts. The Chicago Board of Education, Chicago Park District, and Chicago Sanitary District, each had one or more pegged levies.[21]

It is of course a truism that the restrictiveness of rate limitations is ultimately associated with the assessed valuation upon which they are applied. Presumably this meant during this period that the many individual rates in effect from the abrogation of the Juul Law until 1945 were less restrictive then their full potential since a 1927 statute required that all

[20] *Ibid.*
[21] Vernon Morrisson, *op. cit.*, pp. 122-123.

property be assessed at its true full value. But the full value program was never really enforced. As a result property was assessed through the state at values varying from 14 to 68 percent of full value.[22] This policy naturally caused considerable anguish to property owners who suffered from the inequities implicit in this situation and also placed local governmental units in a difficult position because of the inevitably more restrictive effects of tax rate limits applied against a property tax base assessed far below true value.

In all probability the pressures inherent in an assessment picture of this sort would have in the natural course of events resulted in efforts to correct the vast assessment variances. Yet most experts agree that the impetus for change occurred when on November 3, 1943 the elective Cook County assessor unilaterally raised all assessments in that county from 37% of true value to 100%.[23] The assessor justified his actions on the grounds that the tremendous variances in assessments throughout the state resulted in inequities for those taxpayers living in different assessment districts. He also indicated that a State Supreme Court decision in *Mobile and Ohio Railroad Co.* v. *State Tax Commission* (374 Ill. 75) required that state assessed property be assessed at the state average assessment ratio. This in turn meant that such property was being assessed by the state at still a different value from locally assessed property.[24] "The assessor's action helped to bring pressure to bear on the General Assembly and on the Governor to remedy the situation. The Joint Legislative Committee to Investigate Tax Problems was appointed . . . as a result of their recommendations the so-called Full-Value Assessment Program was passed during the 1945 session and became effective in 1946."[25] As a corollary to the full value program maximum tax rate limits were reduced by one-half, and subjected to further limitation by special formula.[26]

Development of Property Tax Rate Limits In Illinois After 1945

The Full-Value Program

The obvious purpose of reducing the rates was to prevent undue burden on the taxpayer as a result of the full value program. Rates were halved on the theory that the state-wide assessment average was about 50% and consequently increasing this average to 100% would double the taxes of most citizens. The 50% reduction in rates presumably would keep the taxpayers obligations about the same with added benefits both to the taxpayer and the governmental unit coming from uniform assessment implicit in a full value program guarded by an equalization policy supervised by the Property Tax Division of the State Department of Revenue.

[22] *Ibid.*, p. 19.
[23] See for example, Robert H. Pealy, *A Comparative Study of Property Tax Administration in Illinois and Michigan* (Ann Arbor Bureau of Government, Institute of Public Administration, University of Michigan, 1956), p. 88.
[24] John S. Clark, *Crazy Quilt Tax Assessment Hodge-Podge in the State of Illinois*, (Chicago: undated), p. 4.
[25] Robert Pealey, *op. cit.*, p. 89; Chapt. 120, Sec. 627, *Illinois Revised Statutes* (1945).
[26] Chap. 120, Sec. 643a, *Illinois Revised Statutes* (1945).

But the halving of rates was only considered to be a rough effort to maintain rate limit status quo. What of the taxpayer who lived in assessment districts whose assessments varied significantly from the state-wide 50% average? Let us assume first, that he lived in County A which before the 1945 act was assessing at an average of one-third of full value; second, that the true value of his home was $15,000; third, that the county was extending a .0025 corporate rate. In this instance then he paid a tax of $12.50 to the county for corporate purposes, i.e., $5,000 (value of house as assessed) times .0025 (corporate rate before halving). After the full value legislation and the reduction of rates he would theoretically pay $18.75, i.e., $15,000 (house at full value) times .00125 (corporate rate after halving). On the other hand, if the taxpayer with similar property lived in County B which assessed at an average of two-thirds of full value before the 1945 act, and that county also extended the county corporate rate he would pay a tax of $25 to the county for this purpose, i.e., $10,000 (assessed value of house) times .00125 (corporate rate before halving). After the full value legislation and the reduction of rates he would theoretically pay $18.75, i.e., $15,000 (house at full value) times .00125 (corporate rate after halving). Thus the "end effect of the full value assessment program when coupled with the one-half reduction in rate limits was to give counties with assessment ratios below 50% increases in their tax revenue while at the same time reducing the amount of taxes receivable by counties with assessment ratios above 50%."[27]

In order to negate the effects described a transition formula was devised by the Illinois General Assembly for the purpose of obligating local governmental units to adopt limits which would for the most part return tax rates to their effective pre-1946 level. Later, another formula was devised.

Provisions of the 1945 Tax Rate Formula

"Part one of the formula attempted to assure counties with high assessment ratios sufficient revenue to carry on their normal activities by providing that no rate limit should yield an amount less than the ratio of assessed value to full value times the 100% full value for the current year times the legal 1945 tax rate limit."[28] In short, the formula demanded that the taxpayer in County B in the illustration cited above continue to pay $25 after the full value program. For this to occur County B would have to maintain a corporate rate of approximately 16.7 cents per $100 of assessed valuation. This formula then had the effect of increasing the rates of governmental units within counties assessed at more than the state-wide average of 50% to an amount which produced the same amount of revenue as was the case before the 1945 act.

---

[27] Irving Howards, "The Tax Rate Limit Controversy in Illinois," *Current Economic Comment*, Vol. 19, Feb. 1957 (Urbana: Bureau of Economic and Business Research, University of Illinois), p. 25.

[28] *Ibid.*, p. 26.

But as might be assumed most counties had county-wide averages below 50% of full value. For these counties a second formula applied which stated that "unless changed by referendum, 15% was the largest proportion by which any tax rate might exceed the product of the 1942 ratio of assessed to full fair cash value times the maximum tax rate limit effective for the levy and assessment year 1942. An additional provision attempted to restrict any tax extension increase in any one year to 5% of the maximum extendible in 1942."[29] The obvious purpose of this formula was to keep the effective rate limit at an amount which would result in only moderate tax increases.

Both formulae were to be used to determine rates until January 1, 1951, at which time presumably, the prerogative of determining rates according to other statutory provisions would once more be returned to local governments. All taxing districts with a population of more than 500,000 were excepted from the formulae provisions.

Little controversy arose over the formula applicable to counties with assessment averages of 50%. But almost as soon as the formula applicable to counties assessed under 50% went into effect dispute arose as to its meaning. Especially in question was the provision restricting any tax extension increase in any one year to 5% of the maximum extendible in 1942. Some contended that the five percent limitation meant that the 1942 rate times assessed value of the same year could not be increased more than 5% each year up to the maximum of 15%.[30] Others took a more liberal view and suggested that five percent each year was added to the 1942 rate times the assessed value of the same year *plus* any increase up to 15%. The issue was ultimately decided when in 1947 the Illinois Supreme Court in *Grace Anderson* v. *the City of Park Ridge* (396 Ill. 235) declared in favor of the more liberal view noting that any other interpretation would have the effect of holding "certain taxing districts . . . (to) the amount of tax . . . determined on values of 1942 . . . without regard to any increased valuation that may have been added since that year."

Provisions of the 1947 Tax Rate Formula

In view of the contention that the court decision nullified the original intent of this formula, i.e., to hold the approximate effect of rate limits to their pre-1945 levels, the 65th General Assembly authorized a different formula which presumably would accomplish this goal. Because of the new formula provisions rates were to be prescribed by this legislative enactment until December 31, 1952, at which time local rate fixing prerogatives were to be determined according to existing statutory provisions.[31] The assumption was that after the local governments adopted the formula rates they

---

[29] *Ibid.*, p. 26; Chap. 120, Sec. 643a, *Illinois Revised Statutes* (1945).

[30] Taxpayers Federation of Illinois, *The Illinois Taxpayer*, Vol. 6, No. 7, *passim.*

[31] Recall that under the 1945 formula such rate fixing powers were to be returned to local governments by January 1, 1951.

would be free after December 31, 1952, to move to the higher statutory rates established by the 1945 act.

The new formula provisions required that all governmental units of less than 500,000 population[32] compute their rates according to the lesser of these amounts:[33]

a. 105% times $\frac{\text{1942 assessed value times 1945 maximum value}}{\text{1942 full value}}$

b. 105% times $\frac{\text{1945 assessed value times 1945 maximum rate}}{\text{1946 full value}}$

Except for the additional 5% increase in rates implicit in the formula its provisions closely bound the affected governmental units" . . . to their pre-1946 utilization of the property tax."[34]

A Court Challenge to the 1947 Formula

Two major inter-related points of contention surrounding these provisions remained. First, were the rates as prescribed by the formula unrealistic in view of increased needs of local government? Secondly, how long could the General Assembly prescribe formula rates for local governments? Regarding the first issue many agreed that " . . . as the need for government revenues rose, numerous units and funds reached their tax limits. Many jurisdictions where demands for services increased but property values lagged found the new limits restrictive."[35] Regarding the second point, the statutes as indicated, called for a termination of local governments' obligations to compute rates by formula on December 31, 1952. After that time, unless additional legislation was provided, local governments could presumably go to the higher statutory rates. Therefore, the question of formula termination became crucial—one group anxious for its end in order to free local governments from its rates, the other perturbed that unless " . . . some new protections for the property taxpayers . . . (are) enacted by the General Assembly . . . the lid will be off in taxing power . . ."[36]

The two divergent views were well presented in 1950 in the case of *Kremers* v. *the City of West Chicago* (406 Ill. 546). In this instance apparently as a deliberate test, a city library rate determined by formula was made permanent by statute. If the act had been allowed all formula rates might have become permanent and consequently abandoning the formula on December 31, 1952 would have been a meaningless process. The Court did declare this rate unconstitutional on the grounds that it resulted in " . . . a classification that is inherently arbitrary and not based upon any

[32] Also expected were tax rates created after January 1, 1946; tax rates established by referendum after January 1, 1946; and tax rates which by statute were made exempt from the provisions of the Revenue Act. The formula provisions could not limit levies below the amount necessary to receive State grants for general assistance, tuberculosis control, equalization aid for educational purposes, and motor fuel tax funds.

[33] For all practical purposes the second part of the formula has been the one used by all governmental units outside of Cook County. (Interview with Maurice Scott, Executive Secretary, Taxpayers Federation of Illinois, Springfield, Illinois, August 10, 1962).

[34] Vernon Morrison, *op. cit.*, p. 126.

[35] *Ibid.*, p. 126.

[36] Taxpayers Federation of Illinois, *The Story Behind Your Tax Bill* (Springfield: May, 1948), p. 15.

reasonably conceivable set of facts, as certain cities with approximately the same population and burdened with the same responsibility and demands upon their library building funds have different tax rate limitations under its provisions than others thus establishing dissimiliarity in the powers and methods of different cities in the levy and collection of taxes, in violation of Section 22 of Article IV of the constitution." Although it is now contended that the case had no particular effect on the determination of formula rates by legislative fiat since the city library rate was never subject to the formula provisions[37] others agreed that the decision "if applied broadly, meant that permanent tax rate limits fixed by formula could not vary among governmental units of similar population and characteristics. Since rates set by formula . . . had this effect, the possibility of making them permanent was at least of questionable constitutionality."[38]

Hodge-Downing Amendments

Whatever the implications of the Kremers case the Illinois General Assembly in 1951 passed legislation (commonly referred to as the Hodge-Downing Amendments) calling for the abrogation of the *formula provisions* by December 31, 1953 and the determination of the " . . . maximum tax rate limitation for each fund of each taxing district . . . locally or by the voters in each taxing district."[39] In order to accomplish this presumed transition from rates determined by formula to rates set locally according to statutory provisions the law further provided that:[40]

1. Every corporate authority whose rate limits was subject to the Revenue Act, except townships, could by resolution or ordinance passed not later than December 31, 1951, establish "the maximum permissible tax rate limitation that . . . (could) be extended thereafter.[41]
2. The rate established went into effect immediately as long as it was not " . . . greater than the tax rate limit in effect for said fund as of the date of adoption of the ordinance of resolution."
3. If the governing body of a city, village, or incorporated town established a corporate fund rate up to 10 percent greater than "the maximum rate in effect for said fund" as of the date of the adoption of the ordinance or resolution, then a petition by 5% of the electors or 1,000 of the eligible voters — whichever was less — could force a referendum on the increase. However, no city, village, or incorporated town which increased its corporate rate by a referendum passed after January 1, 1946 could increase its rate under these provisions.
4. In the event that a governmental unit did not pass a resolution or

[37] Taxpayers Federation of Illinois, *TFI Tax Clinic-Proceedings* (Springfield: 1958), p. 11.
[38] Irving Howards, *op. cit.*, p. 28.
[39] Chap. 120, Sec. 643b, *Illinois Revised Statutes* (1953). Again exempted were taxing districts of more than 500,000 population and town fund and bond statutes. As in previous legislation rates could not be lower than the amount necessary to qualify for State aid.
[40] The explanation of the Hodge-Downing Amendments are summarized from the *Illinois Revised Statutes, Ibid.*, by Irving Howards, *op. cit.*, pp. 28-29.
[41] In the case of townships, the town board submitted the rate which they adopted to the electors for their approval at the April 1952 town meeting.

ordinance by December 31, 1951, ". . . to the maximum tax rate for such fund . . . (continued) to the maximum tax rate in effect for that fund on December 31, 1951. . ."

5. Any maximum tax rate established can be increased by referendum as long as the increase is not greater ". . . than the maximum tax rate . . . afforded by the terms of any applicable statute."
6. Any increase approved by an ordinance or resolution of the town board and the electors at the April, 1952 town meeting which set a rate limit "greater than the maximum tax rate limit in effect as of the date of adoption (of the ordinance or resolution) could not take effect until a referendum on the subject was approved by the electors of the township."[42]

The Effect of the Hodge-Downing Amendments Upon Tax Rate Limits[43]

In line with the opposing views which appeared in the Kremers case, two major interpretations of the 1951 act once more occurred. One view took the position that abandonment of the formula also implied abandonment of the rates determined by its provisions. Under this logic statutory provisions requiring governing bodies to move to the "tax rate limit in effect" by a resolution or ordinance passed by December 31, 1951 could only mean that local governments could now adopt any rate up to the maximum statutory rate established by the General Assembly in 1945. Using the county corporate rate as an example, a county could under this interpretation move from the rate heretofore prescribed by formula to an amount up to the maximum of 12.5¢. Any other interpretation, it was argued, would have the effect of binding local governments to the formula provisions even though such provisions were stricken from the statutes. Furthermore, it was maintained, any interpretation of the provisions which did not permit local governments to move beyond the formula rates and had the effect of making the formula rate permanent was unconstitutional in view of the State Supreme Court's declaration in *Kremers* v. *City of West Chicago*.

In spite of these arguments others declared flatly that "those rate limitations determined by formula became permanent on December 31, 1951 unless taxing bodies by that date increased them by referenda."[44]

Local government officials, then, found themselves pressured on one hand to adopt the formula rate by action or inaction (unless they chose the referenda); on the other hand they were either encouraged to adopt a higher statutory rate or simply to ignore the December 31, 1951 deadline on the ground that the entire act was probably unconstitutional. As a result the tax rate limit picture since 1951 has been one of immense confusion with most governmental units operating under formula rates[45] but with some utilizing the higher statutory rates. As an illustration it has not been

---

[42] This provision did not apply to the town corporate fund since it was not limited.
[43] For a more detailed analysis see Irving Howards, *op. cit.*, pp. 28-35.
[44] Taxpayers Federation of Illinois, *TFI Tax Clinic-Proceedings*, *op. cit.*, p. 10.
[45] As will be noted a variety of rates have been excepted from the provisions of the formula.

too difficult to discover counties with corporate rates at 12.5¢ despite the Hodge-Downing provisions.[46] Governmental bodies when faced with tax objections to the higher statutory rates, usually allowed the specific objection while maintaining the higher rates for those who did not object.[47]

Court Clarification of How Tax Rates Are Determined

The State Supreme Court was thus faced with the unenviable task of clarifying a statute of great complexity whose meaning was the subject of intense debate by politically sensitive people in the state.

In 1955 for instance in *People* v. *Touchette* (5 Ill. 2d 303) it was contended that the formula provisions according to the precedent established in *Kremers* v. *City of West Chicago* constituted special legislation in violation of Section 22 of Article IV of the Illinois constitution. If this view had been upheld the contention that the Hodge-Downing provisions bound governmental units to formula rates would have been disallowed. But the Court pointed out that the library tax investigated under the Kremers case had never been subject to the formula provisions, that in any event it had not been demonstrated that the formula provisions constituted special legislation and that the Kremers case is ". . . authority only for what was actually there decided, namely that the library statute is invalid." At this point then there seemed to be little question regarding the validity of the rates determined by the provisions of the 1951 act.

But in 1956 another serious challenge was made to the formula provisions in *People* v. *Chicago, Burlington and Quincy Railroad* (8 Ill. 2d 382), this time on the basis of the rates permissible under the Hodge-Downing provisions. In November, 1951 the Bureau County Board of Supervisors adopted a statutory rate of .0375 for the acquisition and maintenance of machinery under the county highway fund. The Chicago, Burlington, and Quincy Railroad objected on grounds that the rate should have been .021, i. e., the formula rate. The court seemingly dealt a devastating blow to those who contended that rates should be prescribed by formula when it noted that the contention that the rates should have been the formula rate was untenable ". . . since the stated purpose of section 162a (643a) is to provide for an orderly transfer from the maximum limits established by the General Assembly to the maximum limits established locally." After this decision, there were many who felt that rates need no longer be bound by the formula provisions.[48]

But the provisions of the 1951 act have proved to be sufficiently pliable to absorb the implications of the C.B. and Q. case without significantly affecting their intent. Thus, in March of 1959, the Supreme Court in *People* v. *Chicago and Northwest Railroad Company* (16 Ill. 2d, 257) defined "tax

[46] Note earlier discussion of this point.
[47] Illinois County Study and Survey Commission, *Source Book on Illinois County Government* (Carbondale: Public Affairs Research Bureau, Southern Illinois University, 1961), Irving Howards, Contributing Editor, pp. 67-72.
[48] See Irving Howards, *op. cit.*, pp. 32-35.

rate limit in effect" in this fashion: (1) where a tax rate limit has been authorized by a referendum held after January 1, 1946; (2) where the fund for which taxes are levied was created after January 1, 1946; and (3) where the fund was in existence on January 1, 1946, and an increase in the rate was not thereafter authorized by referendum . . . ." Under this interpretation, any rate approved by referenda after the adoption of the full-value program was in effect regardless of the action of the governing body involved before December 31, 1951 and even if it were higher than the formula rates. Secondly, any fund not in existence when the full value program went into effect could adopt a higher statutory rate regardless of the action of the governing body involved before December 31, 1951. Third, any other rates not increased by referendum were subject to the formula provisions.

This court decision had two definitive results. It in effect recognized officially that, other than the exceptions noted, most rates were to be bound by the formula provisions unless increased by referenda and, secondly, it minimized the significance of *People* v. *C. B. and Q. Ry. Co.* since " . . . the county highway machinery and equipment tax of .0375 . . . did not become a permanent tax until the 1949 amendment to the Roads and Bridges Act and thus, the statutory rate, not the scaled rate, was held to be the rate in effect on December 31, 1951. . . ."[49]

The trend toward sanctioning the view that with the exceptions noted rates are to be determined by the formula even though the actual formula provisions are not in the statutes was emphasized in March of 1961 in the case of *People* v. *New York City Railroad Company* (22 Ill. 2d, 266). First, the Court once more reaffirmed that rates in existence on January 1, 1946 and not increased by referenda "should be computed according to the formula of section 162a of the Revenue Act as amended in 1947, even though the formula provisions themselves expired." Secondly, the Court denied that the formula provisions are unconstitutional as applied to the county on the grounds that the rates amount to special legislation purportedly determined in *Kremers* v. *City of West Chicago*. Interestingly, the Court in this instance refused the contention on the grounds "that general revenue laws . . . do not fall within the constitutional prohibition forbidding the passage of special laws regulating county and township affairs." The Court was silent on whether formula rates constitute special legislation when applied to municipalities.

Present Status of Property Tax Rate Limits

Thus, after sixteen years of doubt some grounds for discerning legal property tax rates applicable to local governments exists, i. e. unless exceptions are provided rates are to be set at a pre-1946 level as determined by a formula.

As we have observed, among the exceptions are rates increased by ref-

[49] Taxpayers Federation of Illinois, *TFI Clinic-Proceedings* (Springfield: 1959) pp. 22-23.

erenda after January, 1946. Governmental units established after January 1, 1946 or a rate used for the first time after this date may also utilize statutary rates according to the applicable statutes.[50]

But the major exceptions to the concept that rates are to be set by formula are made by specific statutory exemptions. (It will be recalled that this apparently was the situation regarding the city library rate in *Kremers* v. *the City of West Chicago*). As a matter of fact the General Assembly has used this tactic to remove most school districts and many municipal, county and township rates from the purview of the formula provisions. For example, of the approximately 75 different funds available to municipalities outside of Chicago, 9 have rates determined by the formula i.e., corporate, streets and bridges, public benefit, garbage, library (if not incorporated as a city library), playgrounds, band, fire protection or prevention and police protection. Of the approximately 44 different funds available to counties outside of Cook, 12 have rates determined by formula, i.e., corporate, county highway, tuberculosis (cannot be scaled below 5¢) detention home, special road taxes, county library, county fair, county cemetery, county airport, county hospital, county assessment or plat, and cancer and tumor relief; of the approximately 27 different funds available to townships only the general road and bridge are determined by formula. The balance of the rates either have a rather liberal statutory maximum prescribed or in rare instances no limit. For instance, many rates of the municipality, county and township for the purpose of retiring various bonds fall into this category. The township corporate rate also has no statutory limit.[51]

Effect of Existing Rate Limits On Local Government Operations

There is little question but that the rate limit device has become in Illinois a primary means by the State of exercising supervision over local fiscal operations. The State through the General Assembly specifies ". . . the services that local units might perform and . . . limits revenues for each service . . . on the theory that the people of the entire state, acting through state legislation, can better determine the amount of money a particular locality should raise for each governmental service than can the people of the community."[52] Certainly the entire history of determining the rate limits since 1945 is a remarkable testimony to the continued interest of the state in limiting rate-fixing powers of local government. But the actual effect of the rates from 1945 to the present upon the ability of the county,

---

[50] For governmental units created after December 31, 1951 or a governmental unit whose rate was levied for the first time after December 31, 1951 speciai provisions for a time applied. Paragraph 162c of the Revenue Act apparently required in such instance that the rate be scaled to 80% of its maximum. This provision was deleted, however, by the 1959 General Assembly. See also *People* v. *Southern Railway Company*, 21 Ill. 2d 272 (1961) and *People* v. *New York Central Railway Company*, 22 Ill. 2d 266 (1961).

[51] The approximation of the number of funds available to the municipality, county and townships is made from, Thomas Page, Irving Howards, Norman Krausz, *Illinois Property Tax Procedures Manual* (Urbana: Institute of Government and Public Affairs, University of Illinois, 1960), Appendix 7A. Information regarding rates still bound by formula provisions is taken from a letter from Maurice Scott, Executive Secretary, Taxpayers Federation of Illinois, to the author, dated July 19, 1962.

[52] Neil Jacoby, *op. cit.*, p. 306.

the municipality and the township to raise revenue is extremely difficult to determine.

As we have seen the basic purpose of determining rates by the various formulae was to maintain rates at the same amount as they were before the full-value legislation of 1945, although small increases were permitted by the formula with additional rate increments permitted by referenda.[53] Under this policy it was reasoned that the combination of limited local rate adjustments combined with uniform assessment at full value as enforced by state and local equalization programs would permit local governments adequate revenue — even with intimate state supervision over local rate fixing perogatives. An important corollary assumption must have been that increased property values throughout the years would provide the base for any additional revenues needed by the local governments from the property tax. A number of factors, however, have at least modified the theory that rates determined by formula do not really restrict the revenue available to local governments from the property tax.

First, as we have noted, considerable question has existed regarding the constitutionality of the rate limit laws since 1945. In part because of this doubt, in part because of outright confusion as to the meaning of the rate-limit legislation and in part because of the absence of any state agency to enforce the rate limits, some local governments ignored the apparent mandate that most rates be determined by formula. Accordingly, it has not been unusual for rates subject to the formula provisions to be set at the maximum statutory amount. For example, the 1960 abstract of county valuations, levies, tax rates, and tax extensions shows thirteen counties levying a county corporate in excess of the formula rate, with eight such rates at the maximum statutory rate of 12.5¢. Obviously, a forced reduction to the formula rates would have important consequences on the revenue available to the government involved. (Note for example Table I comparing county corporate rates as prescribed by formula to the maximum statutory rate permissible). When the Supreme Court in *People* v. *New York City Railway Company* upheld the formula rates complaints were made by a number of local governments thereby forced to reduce their rates. For example, the Chairman of the Jackson County Board indicated that the reduction in that county's rate from 12½¢ to7.1¢ "would probably force a drastic reduction in county services." In Williamson County the 12½¢ rate brought in $80,291,-97 — a reduction to the formula rate according to county officials would result in a $30,000 per year cut in revenue.[54] Granite City, Illinois officials faced with a reduction in its city corporate rate anticipated a 49% reduction in its property tax income.[55] In these instances at least, rate limits pre-

[53] More liberal provisions were ultimately made for districts created after 1945, or funds being used for the first time after that date, on the theory that the property owner involved was being taxed for these purposes *after* the full value program. Accordingly, there was no need for determining these rates by a formula geared to taxes as they were before 1945.
[54] *Southern Illinoisan*, May 21, 1961.
[55] *East St. Louis Journal*, October 6, 1961.

scribed by formula have caused hardships regardless of the intent of the original statute.

TABLE 1*

County Corporate Rate Under Formula and Statutory Determination

County	Present Rate Limit Under Formula	Rate Under Separate Statute	Difference in Percentage
Adams	11.1	12.5	13
Alexander	11.8	12.5	6
Boone	10.4	12.5	20
Bureau	6.7	12.5	87
Carroll	9.6	12.5	30
Cass	1.1	12.5	14
Champaign	5.7	12.5	119
Christian	8.4	12.5	49
Clark	7.1	12.5	76
Clay	8.4	12.5	49
Clinton	10.1	12.5	24
Coles	5.9	12.5	112
Crawford	7.5	12.5	67
De Kalb	7.7	12.5	62
De Witt	7.5	12.5	67
Douglas	7.5	12.5	67
Du Page	4.6	12.5	172
Edgar	6.3	12.5	98
Effingham	10.0	12.5	25
Fayette	9.8	12.5	28
Ford	6.9	12.5	81
Fulton	9.3	12.5	34
Greene	10.8	12.5	16
Grundy	6.8	12.5	84
Hancock	9.8	12.5	28
Henry	9.1	12.5	37
Iroquois	7.6	12.5	64
Jackson	7.1	12.5	76
Jefferson	6.6	12.5	89
Jersey	9.3	12.5	34
Jo Daviess	10.6	12.5	18
Kane	6.3	12.5	98
Kankakee	6.6	12.5	89
Knox	9.9	12.5	26
Lake	4.6	12.5	172
La Salle	7.5	12.5	67

TABLE 1 (Continued)

County	Present Rate Limit Under Formula	Rate Under Separate Statute	Difference in Percentage
Lawrence	7.9	12.5	58
Lee	8.4	12.5	49
Livingston	7.6	12.5	64
Logan	9.6	12.5	30
McDonough	8.2	12.5	52
McHenry	6.6	12.5	89
McLean	6.7	12.5	87
Macon	6.5	12.5	92
Macoupin	7.4	12.5	69
Madison	5.7	12.5	119
Marion	8.7	12.5	44
Mason	10.1	12.5	24
Mercer	9.2	12.5	36
Montgomery	8.8	12.5	42
Morgan	10.4	12.5	20
Ogle	8.5	12.5	47
Peoria	6.7	12.5	87
Perry	10.3	12.5	21
Pike	8.0	12.5	56
Randolph	9.6	12.5	30
Richland	8.3	12.5	51
Rock Island	7.1	12.5	76
St. Clair	8.4	12.5	49
Saline	6.3	12.5	98
Sangamon	7.5	12.5	67
Shelby	8.8	12.5	42
Stephenson	8.8	12.5	42
Tazewell	6.8	12.5	84
Union	11.3	12.5	11
Vermilion	8.0	12.5	56
Warren	8.0	12.5	56
Wayne	7.8	12.5	60
White	4.6	12.5	172
Whiteside	8.0	12.5	56
Will	5.8	12.5	116
Williamson	7.8	12.5	60
Winnebago	6.1	12.5	105
Woodford	6.7	12.5	87

SOURCE: Derived from information supplied by Taxpayer's Federation of Illinois.
*All counties under 15,000 population according to the 1950 census were omitted since they may increase their county corporate rate to 20 cents by action of their boards. Franklin County is omitted since it may increase its rate to 12½ cents by action of the board. Rate figures are given in cents per one hundred dollars of assessed valuation.

But the primary point regarding the existence of rates determined by formula is first whether such rates are actually equivalent to the rates before the full value program, and, second, whether state equalization and natural increase in property values have been sufficient to provide additional revenues to local governments bound by formula rates.

Using the county corporate rate as a guage one can note that formula rates for county corporate purposes are not adjusted to their pre-1945 levels since in every instance the formula county corporate rate is far below the 25¢ rate permitted before 1945. But of course the key point is the amount of revenue the 25¢ rate brought in, i.e., what the effective county corporate rate was before 1945. Comparison of the formula county corporate rate to the 25¢ rate would be "misleading since no account . . . (would be taken of year-to-year variation in the ration of assessed to full or market valuation of property."[56] One acceptable method of determining the effective rate before the full-value program is to measure the 25¢ rate in each county according to the assessment ratio as it existed before the full value program.[57]

As Table 2 indicates assessment ratios (assessed value as compared to full value) of counties presently subject to the county corporate formula rate varied from 14% in White County to 47% in Alexander County.[58] Such a variance in assessments in comparison to full value meant that the effective 1945 county corporate rate was in all instances far below the actual 25¢ levy. Indeed, in 38 counties the formula rate is substantially the same as the effective county corporate rate as it existed in 1945; and in 36 counties the formula rate is actually higher than the effective county corporate rate as it existed in 1945.[59] According to these figures then, the announced purpose of the formula rate program, i.e., maintaining rates at approximately their 1945 levels, was achieved.

But the second part of the original query, i.e., whether state equalization and increased property values have provided significant increases in revenue available from formula rates is still unanswered. One obvious method of comparing the amount of revenue available to county corporate funds from the formula rate as compared to the amount of revenue available from the effective rates existing as of 1945 is to determine the maximum county corporate extension possible under the applicable rates when applied against

[56] Illinois Department of Revenue, *Illinois Property Tax Statistics 1942* (Springfield: May 1942) p. 2.

[57] *Ibid.*, p. 2. The year 1945 was used as a base for determining the effective rate since it was the last year before the full value program.

[58] The 1945 assessment ratios were obtained from the Department of Revenue, *Illinois Property Tax News Letter*, No. 6 (Springfield: July, 1949), pp. A1-A3.

[59] A formula rate was considered higher than the effective county corporate rate as it existed in 1945 if it varied from the 1945 effective rate by .5 cents or more.

TABLE 2

Assessment Ratios, Effective County Corporate Rates, and County Corporate Formula Rates in Illinois Counties In 1945

Counties	1945 Assessment Ratio	1945 Effective County Corporate Rate (In Cents)	County Corporate Formula Rate (In Cents)
Adams	44	11	11.1
Alexander	47	11.8	11.8
Boone	42	10.5	10.4
Bureau	23	5.8	9.6
Carroll	37	9.3	9.6
Cass	44	11	11
Champaign	21	5.3	5.7
Christian	32	8	8.4
Clark	24	6	7.1
Clay	33	8.3	8.4
Clinton	38	9.5	10.1
Coles	23	5.8	5.9
Crawford	30	7.5	7.5
Dekalb	29	7.3	7.7
Dewitt	27	6.8	7.5
Douglas	28	7	7.5
Dupage	18	4.5	4.6
Edgar	23	5.8	6.3
Effingham	38	9.5	10
Fayette	31	7.8	9.8
Ford	26	6.5	6.9
Fulton	36	9	9.3
Greene	44	11	10.8
Grundy	24	6	6.8
Hancock	36	9	9.8
Henry	35	8.8	9.1
Iroquois	29	7.3	7.6
Jackson	24	6	7.1
Jefferson	22	5.5	6.6
Jersey	38	9.5	9.3
Jo Daviess	42	10.5	10.6
Kane	23	5.8	6.3
Kankakee	24	6	6.6
Knox	38	9.5	9.9
Lake	18	4.5	4.6
LaSalle	28	7	7.5
Lawrence	26	6.5	7.9

TABLE 2 (Continued)

Counties	1945 Assessment Ratio	1945 Effective County Corporate Rate (In Cents)	County Corporate Formula Rate (In Cents)
Lee	31	7.8	8.4
Livingston	27	6.8	7.6
Logan	38	9.5	9.6
McDonough	31	7.8	8.2
McHenry	25	6.3	6.6
McLean	25	6.3	6.7
Macon	25	6.3	6.5
Macoupin	26	6.5	7.4
Madison	20	5	5.7
Marion	29	7.3	8.7
Mason	42	10.5	10.1
Mercer	36	9	9.2
Montgomery	31	7.8	8.8
Morgan	40	10	10.4
Ogle	31	7.8	8.5
Peoria	24	6	6.7
Perry	41	10.3	10.3
Pike	25	6.3	8
Randolph	33	8.3	9.6
Richland	33	8.3	8.3
Rock Island	27	6.8	7.1
St. Clair	31	7.8	8.4
Saline	22	5.5	6.3
Sangamon	29	7.3	7.5
Shelby	32	8	8.8
Stephenson	33	8.3	8.8
Tazewell	25	6.3	6.8
Union	42	10.5	11.3
Vermilion	28	7	8
Warren	30	7.5	6
Wayne	27	6.8	7.8
White	14	3.5	4.6
Whiteside	31	7.8	8
Will	20	5	5.8
Williamson	28	7	7.8
Winnebago	22	5.5	6.1
Woodford	25	6.3	6.7

SOURCE: The 1945 assesment ratios were obtained from *Illinois Property Tax News Letter*, No. 6, Department of Revenue, July 1949. The 1945 "effective rate" was obtained by multiplying the maximum 25 cents county corporate rate against the 1945 assessment ratios. County corporate formula rate was obtained from Table 1.

the existing assessed valuations. As Table 3 suggests in 1960 the county corporate rate in 18 counties brought over $100,000 more than the 1945 effective county corporate rate; in 12 counties from $50,000 to $100,000 more; in 19 counties from $25,000 to $50,000 more; in 21 counties from $10,000 to $25,000 more; and in 3 counties from $5,000 to $10,000 more. These figures tell us nothing about the increased uses of the county corporate rate and the consequent costs involved, but they do at least suggest that rates set on a 1945 base results in an absolute dollar revenue increase because of changing valuations since 1945 combined with the program of state property tax equalization.

TABLE 3

Yield of Maximum County Corporate Rates in 1960 and 1945

County	1960 Maximum Extension With Formula Rate	1945 Maximum Extension With Maximum 25 Cent Rate	1960 Maximum Extension Taking Into Account Consumers Price Index
Adams	$295,323	$171,181	$179,704
Alexander	38,862	32,993	23,648
Boone	88,780	48,127	54,023
Bureau	130,623	88,338	79,484
Carroll	78,269	57,445	47,627
Cass	61,101	37,845	37,180
Champaign	250,322	145,554	152,321
Christian	151,050	84,905	91,914
Clark	37,025	23,938	22,530
Clay	42,064	30,206	25,596
Clinton	75,681	47,128	46,052
Coles	94,515	57,624	57,512
Crawford	58,637	33,116	35,681
DeKalb	176,442	100,935	107,365
DeWitt	72,016	49,406	43,822
Douglas	88,175	52,965	53,655
Dupage	534,298	182,323	325,120
Edgar	74,907	59,528	45,581
Effingham	61,907	38,124	37,670
Fayette	92,163	71,276	56,081
Ford	73,825	49,825	44,923
Fulton	150,628	96,384	91,657
Greene	59,065	40,985	35,941
Grundy	79,362	51,213	48,292
Hancock	112,263	75,303	68,312

TABLE 3 (Continued)

County	1960 Maximum Extension With Formula Rate	1945 Maximum Extension With Maximum 25 Cent Rate	1960 Maximum Extension Taking Into Account Consumers Price Index
Henry	185,479	122,818	112,864
Iroquois	142,159	109,658	86,504
Jackson	68,900	37,783	41,926
Jefferson	57,731	45,842	35,129
Jersey	42,701	24,905	25,984
Jo Daviess	67,589	50,658	41,128
Kane	451,165	232,995	274,534
Kankakee	202,169	102,314	123,020
Knox	236,459	149,533	143,885
Lake	488,798	233,048	297,434
LaSalle	355,403	233,837	216,263
Lawrence	53,401	28,710	32,495
Lee	160,885	105,938	97,899
Livingston	203,109	116,326	123,592
Logan	168,205	95,790	102,353
McDonough	103,194	70,688	62,794
McHenry	242,120	99,050	147,330
McLean	274,890	178,278	167,271
Macon	291,978	168,409	177,669
Macoupin	91,120	63,827	55,447
Madison	452,612	251,885	275,414
Marion	102,518	75,283	62,382
Mason	89,750	44,944	54,613
Mercer	65,313	47,513	39,743
Montgomery	87,249	62,730	53,091
Morgan	152,213	79,771	92,621
Ogle	142,711	97,519	86,840
Peoria	470,619	293,922	286,372
Perry	50,540	36,147	30,754
Pike	58,543	40,348	35,623
Randolph	70,496	45,977	42,897
Richland	43,129	32,027	26,244
Rock Island	341,466	184,173	207,782
St. Clair	596,461	362,820	362,947
Saline	36,890	29,902	22,448
Sangamon	365,871	221,358	222,633
Shelby	90,503	56,440	55,071
Stephenson	145,719	97,342	88,670
Tazewell	293,211	134,340	178,419

TABLE 3 (Continued)

County	1960 Maximum Extension With Formula Rate	1945 Maximum Extension With Maximum 25 Cent Rate	1960 Maximum Extension Taking Into Account Consumers Price Index
Union	44,082	26,422	24,998
Vermilion	243,399	161,896	148,108
Warren	89,828	64,093	54,660
Wayne	49,603	38,008	30,184
White	35,653	30,156	21,695
Whiteside	173,398	98,498	105,513
Will	379,415	205,226	230,874
Williamson	61,487	37,935	37,415
Winnebago	461,002	217,793	280,520
Woodford	83,043	55,551	50,532

SOURCE: The maximum extensions with the formula rate were computed by multiplying the formula rate against assessed valuations supplied by the Department of Revenue. The maximum extensions in 1945 with the maximum 25 cent rate were obtained from the *Illinois Property Tax News Letter*, Department of Revenue, July 1949. Figures in the third column were obtained by multiplying the amounts in column 1 by 60.85% (the value of the dollar in 1960 as compared to 1945).

However, as Column 3, Table 3, suggests an immediate disclaimer must be made in order to take account of the value of the dollar in 1960 as compared to 1945. According to the Bureau of Labor Statistics consumer price index of all items using 1947-1949 as the base indicates that the dollar in 1960 was worth 79.1c compared to $1.30 in 1945.[60] In effect then this means that the 1960 dollar value was approximately 60.85% of the value of the dollar in 1945. Applying this percentage then against the 1960 maximum county corporate extension permissible with the rate determined by formula one obtains a very different picture of the effect of the formula rates. Thus the third column in Table 3 reveals that given the value of the dollar in 1960 compared to 1945, 46 counties have actually experienced a decrease in the amount of money they obtained in 1960 from the county corporate rate; 16 have registered only very moderate revenue increases up to $10,000; while 6 counties received from $10,000 to $25,000 more in 1960 than they did in 1945. Three counties, Kane, McHenry, and Tazewell increased their revenue from the county corporate rate from $25,000 to $50,000; two counties, Lake and Winnebago increased their revenue from $50,000 to $100,000; and only one county, DuPage, increased its revenue by more than $100,000. It is significant to note that all the counties obtaining more than a $25,000 increase are considered metropolitan in nature with four of the six counties located in the Chicago Metropolitan area. In each instance these counties experienced large population and assessed valuation increases. DuPage County for example, increased its population by over

[60] U. S. Department of Labor, *Monthly Labor Review*, 1960 Statistical Supplement, Vol. 83, (Washington: July-December 1960) Table IV-1, p. 19 and Vol. 78 (Washington: 1955), p. 744.

100% in the last ten years and since 1945 increased its assessed valuation compared to the 1945 by over one billion dollars. There is little doubt then that the formula rates set on a 1945 base and applied against existing assessed valuations has in most instances restricted local government revenues to an amount equal to or less than they received in 1945.

Conclusions

As noted the history of rate limit legislation since 1945 has been one which emphasizes an effort to maintain local government rates at an amount equivalent to that which existed before the full value program of 1945. This was done because of the view that without such a policy the full value program would have the effect of inordinately increasing the property tax rates resulting in a windfall for local governments and sharply rising property tax bills for the property owner.

Considerable controversy developed throughout the years regarding the constitutionality and the meaning of legislation directed at maintaining rates at their pre-1946 level. At this writing, however, there seems little question that approximately 9 municipal rates, 12 county rates, and 1 township rate are subject to statutory provisions binding them to a pre-1946 amount. And it should be noted that some of these rates, i.e., county and municipal corporate, municipal streets and bridges, county highway and township road and bridge, are considered major funds for providing fundamental services for the governmental units involved. Other rates have been specifically excepted from the pre-1946 rate policy either by statute or by court interpretation.

An analysis of rate limits as determined by a formula geared to the pre-1946 period compared to the effective rates as they existed before the full value program suggested that such rates are substantially the same or in the case of 36 counties actually higher. And when the formula rate was applied against 1960 assessed valuations as equalized it was demonstrated that the formula rates did, as planned, result in increased dollar amounts for the counties in 1960 as compared to 1945. The problem which arose, however, is that in most instances only moderate increases in assessed valuation occurred in view of the fact that the 1960 dollar was valued at 60.85 cents compared to the dollar in 1945. This meant that only a few counties actually experienced substantial increases in revenue obtained from rates controlled by formula while 46 counties actually experienced a real dollar decrease. The reduction between 1945 and 1960 in the state standard for equalization (from 75 percent to 55 percent) has been an important factor in limiting local property tax levies.

It is difficult to forecast the exact significance upon local fiscal operations of state legislation which binds the amount of money available for important funds to the monies received for similar services before 1946. Absent for example, are any measurements of the increased uses of the

formula-bound funds since 1945. It is possible to state, however, that the county with its heavy dependence upon the property tax as its major locally raised revenue suffers the greatest from the formula rate prescription. The municipality with its broader perogatives for raising local revenues is less severely restricted, although its dependence upon the property tax to the extent of 55% of all local revenue collected means that municipal officials cannot ignore the implications of the formula rates. Townships although having only the road and bridge limited by the formula provisions are hampered both because it depends so heavily upon the property tax for locally raised revenue and because the rate restricted is one of the most basic responsibilities of township government.

A number of alternatives are available to alleviate this situation. First, one can assume that the original logic for determining rates by formula is acceptable and that the excessive restrictiveness of the rates is a matter of an unfortunate coincidence of moderately increasing assessed valuations and a devalued dollar. If this theory is palatable then additional vigor must be extended either through existing legislation or amendments thereto, to force more adequate local assessments. Such a program would tend to alleviate the "tremendous tax inequities" which still prevail within the county and thus form a more adequate tax base upon which formula rates could be applied.[61] Encouragement could also be given for a state equalization program which would increase assessed valuations to a level closer to the full value of property. During the period from 1945 to the present it has been estimated that average county-wide assessments in the state have been changed from a "true value" varying from 75% in 1946 to approximately 51% in 1961.[62]

Obviously then an upward adjustment in "true value" would increase the assessed valuations within each county and lessen the effect of the postwar decline in the value of the dollar upon local government operations. An additional possibility is the computation of property tax rates by a formula periodically altered to take account of the changing value of the dollar as indicated by changes in the consumer price index. Last, revenue from existing formula rates can be supplemented by providing additional local tax sources—particularly for the county.

An obvious alternative to these proposals would be to abandon the formula rate concept either by providing continual exceptions to its provisions or by simply giving local governments authority to move in all instances by action of their governing bodies to the statutory rate established in 1945 when rates were halved. The latter alternative would provide the maximum permissible amount of local property tax revenue to local governments but

---

[61] Glenn W. Fisher, "An Economist's Appraisal of the Illinois Tax System," *op. cit.*, p. 579. These disparities prevail even though county boards of review may equalize assessments between and within taxing districts. (See Chap. 120, sec. 588-589, *Illinois Revised Statutes*, 1951).

[62] Illinois Legislative Council, *Equalization of Property Tax Assessments* (Springfield: Bulletin 3-018, 1957), p. 9; Robert Pealey, *op. cit.*, pp. 99-100; interview with Maurice Scott, Executive Secretary, Taxpayers Federation of Illinois, August 10, 1962, Springfield, Illinois.

would, as this discussion has implied, be a difficult practical goal to achieve.

In all probability pressure by the county, the municipality and the township for additional revenue to support local services will be great regardless of the existence of formula rates. But in view of the effect of the formula rates upon major local government funds, needs for additional revenue are more intense. If the county, the township and to some extent the municipality continue to depend heavily upon the property tax for locally raised revenue then the existing rate limit provisions will obligate these local governments to either reduce or provide minimal services, operate with illegal rates, or seek additional monies from the state or even the federal government in the form of grants or shared taxes.

CHAPTER XVI

INHERITANCE TAX

by Robert N. Corley*

The purpose of this study and analysis are (1) to ascertain whether death and related taxes can provide additional revenue to the state without imposing undue economic burdens; (2) to determine whether there are inequities and defects in the tax or in its administration; and (3) to find possible means of improving the administration of such taxes.

Recent Developments

In the *Report of the Revenue Laws Commission of the State of Illinois,* 1949, Professor J. Nelson Young discussed the history of the Illinois inheritance tax. No useful purpose would be served in reviewing the development of the inheritance tax to that date. Subsequent to his study, the following changes have been made in the inheritance tax:

1. In addition to the basic inheritance tax, an additional tax is imposed on estates subject to the federal estate tax equal to the maximum credit allowable for state death taxes against the federal estate tax imposed with respect to the portion of the decedents estate having a taxable status in Illinois less the inheritance taxes, if any, due this state. The purpose of this change was to give Illinois the full benefit of the maximum credit allowable under the federal estate having a taxable status in Illinois. This change was recommended by the 1949 Commission[1] and the reasons therefore were discussed in detail by Professor Young.[2]
2. Returns are now filed within 16 months from date of death and the tax must be paid within 18 months to avoid interest being due from date of death.[3] (This solves the problem raised in the Young discussion on p. 439.)
3. In 1949, 1951 and 1953 certain changes were made in the provisions relating to property passing to Class I beneficiaries and especially in the provision relating to property received by a "mutually acknowledged child." Descendents of a mutually acknowledged child were included in Class I for tax purposes. The amendment of 1951 also made legal adoption the equivalent of blood relationship.[4]
4. In 1953, Sec. 21 of the Act was amended to provide that 4 percent instead of 2 percent of all taxes paid to a county treasurer shall be retained by him for county costs in administering the tax.[5]
5. In 1959, Sec. 25 on contingent interests was changed to simplify

*The author is Associate Professor of Business Law at the University of Illinois.

[1] *Report of the Revenue Laws Commission,* 1949, Part I, p. 25.

[2] *Ibid.,* Part II, pp. 427-434.

[3] *Ibid.,* Part I, p. 25.

[4] Smith-Hurd *Annotated Statutes,* Ch. 120, Sec. 375. *Illinois Inheritance Tax Manual,* William G. Clark, Attorney General, *Illinois Inheritance Tax Manual,* 1961, p. 32.

[5] Smith-Hurd *Annotated Statutes,* Ch. 120, Sec. 394.

the administrative procedures for determining the tax on future interests. The problems inherent in the former statute were discussed in the 1949 report (pp. 441-445). Under old Sec. 25 when property was transferred or limited in trust or otherwise, and the interests of the beneficiaries were dependent upon contingencies or conditions, whereby they could be wholly or in part created, defeated, extended or abridged, a tax was imposed on the transfer at the highest rate possible on any of the conditions or contingencies. A refund was provided on the removal of the contingency. A tentative tax was also provided for which was based on the most likely succession with the privilege of paying the tentative tax in cash and covering the difference between the tentative tax and the contingent with bonds in the amount of 150 percent of the difference.

The new Sec. 25 provides that the tax shall be imposed upon the transfer at the rate which would be applicable on the happening of the most probable of the contingencies or conditions, based on the likely number and relationship of those to whom the property will eventually be transferred taking into consideration any applicable mortality and other experience tables and the number and ages of all persons in being when the tax is assessed. In the event the tax paid is too high, a procedure for redetermination is available. Thus the tentative tax provisions which complicated administration have been eliminated.

Importance of Tax as a Source of Revenue

Table 1 sets forth the Illinois inheritance tax collections for the fiscal years 1949-61. While the tax has not been a highly productive one, the total revenue produced has substantially increased in the last ten years. Many of the recommendations hereinafter set forth are designed to obtain substantial increase in the revenue from this source.

Table 2[6] sets forth state inheritance, estate, and gift tax collections by states, 1960. (This table is for the calendar year 1960 while Table 1 is for fiscal years.)

For information relative to collections for years prior to 1948, see the 1949 Report of the Revenue Laws Commission, p. 414.

It will be noted that 12 states obtain a greater portion of their revenue from this source than does Illinois. A closer look reveals that many of the states with population, wealth and natural resources similar to Illinois are in this category.

The Estate Tax as a Possible Alternative to the Inheritance Tax

Before commenting on specific problems and making recommendations relative to the inheritance tax, certain observations relative to an estate tax as a possible death tax need be made.

---

[6] Quoted in *Coordination of State and Federal Inheritance, Estate, and Gift Taxes*, Advisory Commission on Intergovernmental Relations, 1961, p. 36.

TABLE 1
Illinois Inheritance Tax Collections

Fiscal Year	Total Collections*	Percent of Total State Revenues†
1961	$34,280,993	3.7
1960	23,888,529	2.7
1959	22,070,005	2.8
1958	21,547,754	2.8
1957	20,846,307	2.9
1956	20,628,421	3.1
1955	15,968,750	2.8
1954	13,681,652	2.4
1953	13,469,081	2.5
1952	12,196,341	2.5
1951	9,507,278	2.2
1950	8,263,942	2.0
1949	9,462,228	2.2
1948	10,451,926	2.5

SOURCE: Biennial Reports of the Auditor of Public Accounts and of the Department of Finance.
*Gross receipts.
†Net revenues.

TABLE 2

State Inheritance, Estate, and Gift Tax Collections, by States, 1960
(Dollar Amounts In Thousands)

State	All State Taxes (1)	Death and Gift Taxes: Amount (2)	Death and Gift Taxes: Percent Of Column (1) (3)	Death and Gift Taxes: Percent Of All States (4)
Alabama	$ 274,239	$ 705	0.26	0.17
Alaska	27,110	54	.20	.01
Arizona	164,153	463	.28	.11
Arkansas	158,118	241	.15	.06
California	2,124,369	47,180	2.22	11.26
Colorado	192,542	6,638	3.45	1.58
Connecticut	238,124	16,920	7.1	4.04
Delaware	70,776	1,088	1.54	.26
Florida	521,682	5,488	1.05	1.31
Georgia	369,080	981	.27	.23
Hawaii	124,230	587	.47	.14
Idaho	68,909	751	1.09	.18
Illinois	836,372	22,027	2.63	5.26
Indiana	399,379	7,563	1.89	1.80

TABLE 2 (Continued)

State	All State Taxes (1)	Death and Gift Taxes: Amount (2)	Death and Gift Taxes: Percent Of Column (1) (3)	Percent Of All States (4)
Iowa	265,787	7,294	2.74	1.74
Kansas	206,622	3,727	1.80	.89
Kentucky	228,507	5,302	2.32	1.26
Louisiana	452,705	7,311	1.61	1.74
Maine	86,929	3,229	3.71	.77
Maryland	343,577	4,987	1.45	1.19
Massachusetts	491,123	20,535	4.18	4.90
Michigan	913,920	12,124	1.33	2.89
Minnesota	351,923	7,335	2.08	1.75
Mississippi	194,300	666	.34	.16
Missouri	312,895	5,259	1.68	1.25
Montana	64,868	1,775	2.74	.42
Nebraska	91,253	374	.41	.09
Nevada	43,478	—	—	—
New Hampshire	41,757	2,093	5.01	.50
New Jersey	365,232	20,621	5.65	4.92
New Mexico	123,206	676	.55	.16
New York	1,961,008	71,611	3.65	17.08
North Carolina	459,373	6,644	1.45	1.59
North Dakota	60,760	278	.46	.07
Ohio	872,723	8,694	1.00	2.07
Oklahoma	275,379	6,396	2.32	1.53
Oregon	208,099	4,523	2.17	1.08
Pennsylvania	1,029,478	51,121	4.97	12.20
Rhode Island	86,095	3,873	4.50	.92
South Carolina	234,990	1,596	.68	.38
South Dakota	52,828	927	1.75	.22
Tennessee	304,587	4,844	1.59	1.16
Texas	777,863	11,500	1.48	2.74
Utah	103,460	1,017	.98	.24
Vermont	43,414	733	1.69	.17
Virginia	291,664	5,176	1.77	1.23
Washington	460,770	9,422	2.04	2.25
West Virginia	179,919	2,430	1.35	.58
Wisconsin	426,234	14,039	3.29	3.35
Wyoming	41,460	344	.83	.08
Total	$18,017,359	$419,162	2.33	100.00

SOURCE: Bureau of the Census, Governments Division.
NOTE: Due to rounding, detail will not necessarily add to totals.

An estate tax is a tax imposed on the right to transmit property at death or a tax on the property itself. It is computed by totaling the fair market value of all property subject to the tax without regard to the persons who will receive the property and their relationship to the deceased. An inheritance tax is imposed on the right to receive property and is assessed against the beneficiary. The amount of the tax is determined after taking into account the exemptions provided for the relationship to the deceased and the tax rates for that class of beneficiary. The major advantage of the inheritance tax is that it allows the death tax incidence to take into account the needs of surviving spouses and minor children by granting greater exemptions and lower rates to beneficiaries dependent on the deceased than to those not so dependent. The major advantage of the estate tax is found in simplified administration. Since the estate tax is assessed against the property without regard to the takers of the property, problems such as will construction, application of local probate law and contingent future interests are eliminated. Thus, an estate tax gives simplified administration but at the expense of flexibility in the incidence of the tax. It should be noted that the estate tax is generally imposed in fewer states than is the inheritance tax and without a substantial change in the credit and exemptions, the estate tax would probably produce less revenue than the inheritance tax.

Consideration is being given by the Congress (See H.R. 8600, 87th Congress, 1st Session and the Report of the Advisory Commission on Intergovernmental Relations) to a basic change in philosophy concerning state death taxes. Historically, it was felt that the major portion of revenue produced by death taxes should go to the states. This was the basic reason for the 80 percent credit on the federal estate tax for death taxes paid to states. As the federal government required more revenue, the federal estate tax rate increased and the exemptions were decreased without any change in the credit, so that today, only a small portion of the total estate tax finds its way to the states. The federal government's percentage of death taxes has risen steadily and the states' percentage has declined to about 21 percent of the total death tax collections. In 1957, the states' share of death taxes was 54.1 percent and in 1932 was 78.3 percent.[7] In 1929, the state death tax credit was 73.8 percent of the federal tax liability before the credit. In 1936 it was 18.5 percent and in 1959 it was 9.77 percent.[8]

In January 1961, the Advisory Commission on Intergovernmental Relations submitted certain recommendations relative to the coordination of state and federal inheritance, estate and gift taxes. The goal of these recommendations is to secure for the states a larger portion of the total death taxes paid. Several alternatives for accomplishing this purpose are set forth and it is suggested that they be reviewed in detail. The basic concept of these recommendations must be noted however. States will be required to have

[7] *Ibid.*, p. 4.
[8] *Ibid.*, p. 5.

an estate tax instead of an inheritance tax to provide uniformity throughout the country. Therefore, the General Assembly perhaps out to consider adoption of an estate tax at this time. Such a tax might take one of the following forms:

1. Illinois could adopt its own estate tax with its own exemptions, rates and deductions and rules. The rates could be such as to take advantage of any possible federal credit.
2. The Illinois tax could be a flat percentage (such as 40 percent) of the federal tax. Thus, the only administration required would be to receive a copy of the federal tax return and a copy of the letter approving it. This would automatically incorporate the federal marital deduction and would greatly reduce the cost and other burdens of administration of the tax.
3. A completely federal plan could be adopted by the Congress whereby the federal government would collect the tax, and simply remit the state's portion to it based on the federally ascertained credit.

Table 3[9] classifies the types of tax imposed on each state as of January 1962. It is noted that only 8 states have a true estate tax and 4 more states have an estate tax to pick up the federal credit only. Several states will undoubtedly consider the estate tax as a result of the aforesaid report of the Advisory Commission. If the states are going to receive the majority of death taxes, then an estate tax at the state level will ultimately be a reality. A substantial increase in the federal credit will only be passed as a part of a uniform death tax scheme.

Even if Illinois does not adopt an estate tax at this time, the provisions of the federal estate tax should be kept in mind when analyzing the Illinois inheritance tax and when considering possible revisions. Any revision of the Illinois inheritance tax that tends to make it uniform with the federal estate tax may be desirable as a step toward the establishment of a state estate tax. In addition, uniformity will assist in simplifying administration of the inheritance tax as well as assist persons in understanding death taxes and the problems of estate planning. Until federal legislation increases the state death tax credit and makes an estate tax mandatory, it is felt that the inheritance tax with its flexible rates and exemptions should be retained with certain modifications.

Recommendations

Recommendation No. 1: Life insurance payable to a named beneficiary over which the deceased possessed the incidents of ownership should be subject to the inheritance tax after allowing an additional exemption for a surviving spouse of the first $20,000 of life insurance and an additional exemption for a minor child of the first $5,000 of life insurance. The proceeds of accidental death policies should also be subject to the tax on the same terms.

[9] Commerce Clearing House, *Estate, Inheritance, and Gift Tax Service,* Vol. IV, p. 80,041.

TABLE 3

Classification of State, Inheritance, Estate and Gift Tax Laws, January 1, 1962

State	Inheritance Tax	Additional Estate Tax for Federal Credit	Estate Tax	Estate Tax for Federal Credit Only	Gift Tax
Alabama				x	
Alaska	x	x			
Arizona		x	x		
Arkansas				x	
California	x	x			x
Colorado	x	x			x
Connecticut	x	x			
Delaware	x	x			
District of Columbia	x	x			
Florida				x	
Georgia				x	
Hawaii	x	x			
Idaho	x	x			
Illinois	x	x			
Indiana	x	x			
Iowa	x	x			
Kansas	x	x			
Kentucky	x	x			
Louisiana	x	x			x
Maine	x	x			
Maryland	x	x			
Massachusetts	x	x			
Michigan	x	x			
Minnesota	x	x			x
Mississippi	x	x	x		
Missouri	x	x			
Montana	x	x			
Nebraska	x	x			
Nevada					
New Hampshire	x	x			
New Jersey	x	x			
New Mexico	x	x			
New York		x	x		
North Carolina	x	x			x
North Dakota			x		
Ohio	x	x			
Oklahoma		x	x		x

TABLE 3 (Continued)

State	Inheritance Tax	Additional Estate Tax for Federal Credit	Estate Tax	Estate Tax for Federal Credit Only	Gift Tax
Oregon	x				x
Pennsylvania	x	x			x
Puerto Rico	x				x
Rhode Island	x	x	x		x
South Carolina		x	x		
South Dakota	x				
Tennessee	x	x			x
Texas	x	x			
Utah			x		
Vermont	x	x			
Virginia	x	x			x
Washington	x	x			x
West Virginia	x				
Wisconsin	x	x			x
Wyoming	x	x			

SOURCE: Commerce Clearing House, *Estate, Inheritance and Gift Tax Service,* Vol. IV, p. 80,041.

At the present time, the proceeds of life insurance payable to an estate or to executors or trustees for the benefit of the estate are subject to the tax. In addition, the proceeds of matured endowment policies owned by a decedent upon whose death the unpaid balance is to be paid to the decedent's estate or to named beneficiaries is subject to tax. The proceeds of supplementary contracts issued upon maturity of previous life insurance policies owned by the decedent, the value of a supplemental contract or certificate of deposit when the decedent was the beneficiary in another insurance policy, proceeds of refund annuity contracts owed by the decedent and decedents vested interest in pension, retirement, and profit sharing plans are subject to the tax. Life insurance and accidental death policies payable to a named beneficiary are not subject to the Illinois inheritance tax.[10]

Under the federal estate tax, life insurance payable to a named beneficiary over which the deceased had the incidents of ownership is included in the computation of the gross estate for tax purposes. Prior to the 1954 Internal Revenue Code, life insurance on a policy on which the decedent paid the premiums was also included. The 1954 Code dropped the premium payment test and reduced the taxation of life insurance to only those policies in which the deceased had the incidents of ownership. By incidents of ownership is meant such powers as the right to change the beneficiary, the

[10] *Illinois Inheritance Tax Manual, op. cit.,* p. 16.

right to borrow on the policy or the right to the cash surrender value. In 1959, $214,000,000 in death benefits were paid in Illinois and in 1960, $239,000,000 were paid. Approximately 95 percent of these were paid to named beneficiaries and were not subject to the Illinois inheritance tax.

While most states still do not tax life insurance, there is a trend toward including insurance in those items which are subject to inheritance tax. For example, the State of California taxes not only the proceeds of life insurance payable to the estate but also payments to a named beneficiary and under which the insured has the right to change the beneficiary or has the right of cash surrender.[11] Thus, California is using the same test as the federal government, namely, the incidents of ownership test. Recognizing that life insurance is used to provide for dependents, the State of California has in addition to the usual exemption, created an additional exemption of $50,000 of the aggregate proceeds from insurance.[12] This additional exemption is considered too high for our tax rates and it is believed that the lower additional exemption recommended will not create an urgent economic burden when the tax rates are considered. It would seem that insurance payable to someone who is not dependent on the insured should be subject to tax without an additional exemption.

At the present time the recipients of insurance are given a favored treatment over the recipients of other property such as stocks, bonds, or real estate. While there have been technical arguments advanced in the past as to a distinction between insurance and other types of wealth which are created on death, these are more of form than substance and there seems no valid reason why the state should not tax insurance proceeds which are received upon the death of a Illinois resident over and above certain reasonable exemptions which are necessary to protect widows and children. Insurance is similar to a trust or other arrangement by which a person's interest takes effect at death. The interest can be eliminated during lifetime by simply not paying the premiums and the interest certainly takes effect at death. Taxation of accident insurance by which large accumulations of wealth are created for a relatively low premium should not be prevented simply because they arise from a contract relationship. Taxation of insurance should not complicate the administration of tax in that the usual procedures for consents to transfer could be required before the proceeds of any insurance policy could be paid to a beneficiary.

There are certain constitutional considerations involved which are discussed in the earlier report by Professor J. Nelson Young. He indicates that taxation of life insurance based on the premium payment test would also be constitutional. While the same arguments for taxing proceeds of such policies are apparent, ease of administration would seem to indicate that Illinois should adopt the same basis as the federal tax .

[11] *California Revenue and Taxation Code*, Div. 2, Art. 6, Sec. 13723.
[12] *Ibid.*, Sec. 13724.

Recommendation No. 2: The value of any interest in property transferred within three years before the decedent's death, unless the transfer is shown not to have been made in contemplation of death, should be subject to the inheritance tax.

At the present time, the Illinois inheritance tax law provides that transfers made by gift within two years prior to the death of the donor shall *prima facie* be in contemplation of death. The presumption is not conclusive and gifts made more than two years may be taxed and those within two years need not be taxed.[13] Eighteen states have adopted the federal rule of three years as a time limit beyond which a gift is clearly not taxed. This period of certainty allows for gifts to be used as an estate planning tool. The Illinois law and the federal law should be consistent to allow ease of administration and to provide certainty in estate planning. The additional year should prevent a loss of revenue to the state in the outlawing the taxation of gifts over three years from the date of the donor's death.

Recommendation No. 3: That a gift tax be established as an adjunct of the inheritance tax. The gift tax would be at the same rate but additional exemptions and exclusions would be allowed. The federal exemption of $30,000 and exclusion of $3,000 could be used or a graduated exemption could be established.

At the present time, the gift is a valuable estate planning tool to avoid the federal estate tax. The federal gift tax rate is three-fourths that of the estate tax in each bracket and donors are given a $30,000 lifetime exemption with an additional $3,000 exclusion per year per donee. Thus, persons with large estates are given a great incentive to make inter-vivos transfers of property. Many persons are taking advantage of the tax savings through inter-vivos gifts. In Illinois once the gift is made, it is tax free unless in contemplation of death. The federal government is receiving revenue from this source as are 13 states. Substantial amounts of property are being transferred in avoidance of the Illinois inheritance tax because of this void in our tax laws.

Table 4 illustrates the revenue experience of 12 states which levied a gift tax for the period 1949-1957. Income for subsequent periods would be higher as a result of the general increase in property values during the period.

Table 5 sets forth the exemptions, rates, and exclusions used by the various states imposing a gift tax as of July 1, 1957. These are substantially unchanged as of today. They furnish a basis for fixing the Illinois provisions.

Recommendation No. 4: A provision should be added exempting transfers of property in an estate from the inheritance tax to the extent that the transfer thereof was previously taxed in the estate of a decedent within two years prior to the second transfer.

[13] *Inheritance Tax Manual, op. cit.*, pp. 22-23.

TABLE 4

State Gift Tax Collections
Fiscal Years, 1949-1957
(In Thousands of Dollars)

State	1949	1950	1951	1952	1953	1954	1855	1956	1957
California	$1,367	$1,205	$1,967	$1,400	$1,595	$1,682	$1,831	$2,163	$2,559
Colorado	76	35	195	103	109	419	207	299	281
Louisiana	126	110	122	121	101	156	119	143	79
Minnesota	90	117	171	188	85	120	693	466	630
North Carolina	375	124	559	265	265	453	358	415	431
Oklahoma	150	226	277	208	297	310	603	506	501
Oregon	63	57	133	96	104	81	145	100	464
Rhode Island	12	30	122	101	299	55	79	51	191
Tennessee	113	82	208	111	188	81	200	202	147
Virginia	87	104	488	89	138	128	125	204	209
Washington	250	96	237	130	381	350	229	283	500
Wisconsin	599	537	880	1,030	825	613	758	943	1,281
Total	$3,298	$2,743	$5,368	$3,842	$4,387	$4,448	$5,347	$5,775	$7,273

SOURCE: Adapted from *Federal and State Inheritance and Estate Taxes*, Treasury Department, Analysis Staff, Tax Division, 1957, p. 6.

One of the inequities of the current tax arises from deaths which are almost simultaneous or where there is a short holding period. For example, if a husband and wife die within six months of each other, the property is fully taxed in both estates even though the second to die may not have actually obtained the use of the property because administration of the first estate was not complete. The federal estate tax provides for 100 percent credit if the second party dies within 2 years, 80 percent credit if within four, 60 percent if within six, 40 percent if within eight and 20 percent if within ten years. While the rates of the inheritance tax are not large enough to break up large accumulations of wealth, it is obviously unfair to tax property twice when two people die within one day of each other. Thirty-two states have provisions allowing credits or deductions for prior taxed property. Illinois should join this group for reasons of equity.

Recommendation No. 5: The Illinois basic exemptions should be changed to the following:

1. Widow 30,000
2. Widower 25,000
3. Minor child 20,000
4. Adult child 10,000
5. Son-in-law, daughter-in-law, widow of son, widower of daughter 5,000

State Inheritance Tax Exemptions And Rates, For Selected Categories Of Heirs, July 1, 1957

State*	Widow	Exemptions				Rates				In Case of Spouse	
		Minor Child	Adult Child	Brother or Sister	Other than Relative	Spouse or Minor Child	Adult Child	Brother or Sister	Other than Relative	Size of First Bracket	Level at Which Top Rate Applies
Alabama†	$	$	$	$	$					$	$
Arizona†											
Arkansas†											
California‡, §	24,000	12,000	5,000	2,000	50	2-10%	2-10%	5-15%	7-16%	25,000	500,000
Colorado	20,000	10,000	10,000	2,000	500•	2-8	2-8	3-10	7-16	50,000	500,000
Connecticut‡, **	50,000	10,000	10,000	3,000	500	2-8	2-8	3-9	8-14	25,000	1,000,000
Delaware‡	20,000	3,000	3,000	1,000		1-4	1-4	2-5	5-8	50,000	200,000
Dist. of Col.‡	5,000	5,000	5,000	2,000	1,000	1-5	1-5	3-10	5-15	50,000	1,000,000
Florida†											
Georgia†											
Idaho§	10,000	10,000	4,000	1,000		2-15	2-15	4-20	8-30	25,000	500,000
Illinois	20,000	20,000	20,000	10,000	100	2-14	2-14	2-14	10-30	20,000	500,000
Indiana‡	15,000	5,000	2,000	500	100	1-10	1-10	5-15	7-20	25,000	1,500,000
Iowa	40,000	15,000	15,000			1-8	1-8	5-10	10-15	10,000	300,000
Kansas	75,000	15,000	15,000	5,000	200•	0.5-5	1-5	3-12.5	5-15	25,000	500,000
Kentucky	10,000	10,000	5,000	1,000	500	2-10	2-10	4-16	6-16	20,000	500,000
Louisiana‡, §	5,000	5,000	5,000	1,000	500	2-3	2-3	5-7	5-10	5,000	20,000
Maine	10,000	10,000	10,000	500	500	2-6	2-6	8-12	10-16	50,000	250,000
Maryland•	150	150	150	150	150	1	1	7½	7½	Entire Share	Entire Share
Massachusetts•, ††	10,000	10,000	10,000	1,000	1,000	1-9	1-9	4-15	6-15	10,000	1,000,000
Michigan‡, ‡‡	30,000	5,000	5,000	5,000		2-8	2-8	2-8	10-15	50,000	750,000
Minnesota‡	10,000	10,000	5,000	1,000	100	1-12	1-12	3-36	5-60	15,000	1,100,000
Mississippi†											
Missouri‡	20,000	5,000	5,000	500	100•	1-6	1-6	3-18	5-30	20,000	400,000
Montana‡	17,500	2,000	2,000	500		2-8	2-8	4-16	8-32	25,000	100,000
Nebraska‡	10,000	10,000	10,000	10,000	500	1	1	1	6-18	Entire Share	Entire Share
Nevada		No tax imposed									
New Hampshire	No tax	No tax	No tax			No Tax	No Tax	8.5	8.5	No Tax	Entire Share
New Jersey‡	5,000	5,000	5,000	500•	500•	1-16	1-16	5-16	8-16	50,000	3,700,000
New Mexico§, **	10,000	10,000	10,000	10,000	500	1	1	5	5	Entire Share	Entire Share
New York†											
North Carolina	10,000	5,000	2,000			1-12	1-12	4-16	8-17	10,000	3,000,000
North Dakota											
Ohio‡	5,000	5,000	3,500	500		1-4	1-4	5-8	7-10	25,000	200,000
Oklahoma†											
Oregon***	No tax	No tax	No tax	1,000	500	No Tax	No Tax	1-20	4-25	No Tax	No Tax
Pennsylvania	750					2	2	15	15	Entire Share	Entire Share
Rhode Island‡, ¶	10,000	10,000	10,000	5,000	1,000	1-7	1-7	2-8	5-11	25,000	1,000,000
South Carolina	10,000	7,500	5,000	500	200	1-6	1-6	2-7	4-14	20,000	300,000
South Dakota***	10,000	10,000	10,000	500	100	1-4	1-4	3-12	5-20	15,000	100,000
Tennessee‡	10,000	10,000	10,000	1,000	1,000	1-7	1-7	5-15	5-15	25,000	500,000
Texas‡, §	25,000	25,000	25,000	10,000	500	1-6	1-6	3-10	5-20	50,000	1,000,000
Utah†											
Vermont‡	13,000	15,000	15,000			2-6	2-6	12	12	25,000	250,000
Virginia	5,000	5,000	5,000	2,000	1,000	1-5	1-5	2-10	5-15	50,000	1,000,000
Washington‡, §	10,000	5,000	5,000	1,000		1-10	1-10	3-20	10-25	25,000	500,000
West Virginia***, ‡	15,000	5,000	5,000			3-13	3-13	4-18	10-30	50,000	1,000,000
Wisconsin‡, §§	15,000	2,000	2,000	500	100	2-10	2-10	2-10	8-40	25,000	500,000
Wyoming	10,000	10,000	10,000	10,000		2	2	2	6	Entire Share	Entire Share

SOURCE: *Federal and State Inheritance and Estate Taxes,* Treasury Department, Analysis Staff Tax Division, 1951, pp. 18-20.

*All States, except those designated by three asterisks (***) imposes an estate tax to assure full absorption of the 80 percent Federal credit.

†Imposes only estate tax. See Table 7.

‡Exemptions are deductible from the first bracket.

§Half of community property passing to surviving spouse is not taxable.

¶Imposes also an estate tax. See Table 7.

•No exemption is allowed if beneficiary's share exceeds the amount shown in the exemption column.

**The exemption shown is the total exemption for all beneficiaries falling into the particular class and is shared by them proportionately.

††Additional taxes, equal to 23% of the inheritance tax, are also imposed.

‡‡Transfers of real property are taxed at ¾ths of the indicated tax rates.

§§These rates are subject to the limitation that the total tax may not exceed 15% of the beneficiary's share. An additional tax equal to 30% of the inheritance tax is also imposed.

6.	Parents	5,000
7.	Grandchild	5,000
8.	Brothers-Sisters	5,000
9.	Grandparent	1,000
10.	Nephews and nieces, aunts, uncles, cousins or descendants thereof	100
11.	Friends	—0—
12.	Charities	—0—

Illinois at the present time has three classes of exemptions, in addition to the charitable, religious, or education bequests which are wholly exempt. Class I includes fathers, mothers, lineal ancestors, or descendants of decedent, husband, wife, child, wife or widow of a son, or husband or widower of a daughter, and mutually acknowledged children and their descendants. The exemption is $20,000 for all parties in Class I except brothers and sisters for whom the exemption is $10,000.

Class II is an exemption of $500 for uncles, aunts, nieces, nephews and lineal descendants thereof. Class III is $100 exemption for all other parties, which usually means friends.

Many states today are recognizing the fact that minor children have greater need than do adult children and therefore should be given a larger exemption. In addition, a wife is probably in most cases entitled to a larger exemption than is a husband who at least in theory is capable of supporting himself. The Illinois exemptions have not been changed since the original adoption of the act and this is one argument for raising the exemptions. However, Illinois' exemptions for the most part are rather liberal in comparison with other states (See Table 6). There seems to be a need for a complete realignment of these exemptions.

The aforesaid exemptions would recognize the basic economic facts of the dependency of wives and minor children and with the additional exemption for insurance and the rates as hereinafter set forth, the tax should not be an economic burden to anyone but should provide the state with a source of revenue and from a source that is able to pay it without economic hardship.

Insofar as the charities are concerned, the State of Iowa, for example, is now taxing charities by a special rate without exemption.[14] The State of New Jersey is taxing all gifts to charities over $5,000.[15] Charities have become a method of tax avoidance to persons who are not necessarily interested in the charity but only in avoiding taxes. Many argue that this results in an improper allocation of resources and is economically unsound. The same arguments for eliminating or reducing the charitable exemption in income taxes, and other taxes are applicable here. With the amount of protection given charities under the income tax law, there seems to be no

[14] *Inheritance Tax Computation Charts*, Inheritance Tax Division, State Tax Commission, p. 3.
[15] *New Jersey Revised Statutes*, Sec. 54:34-2.

valid reason for not collecting a proportionate share of the gift to charities under the inheritance tax. There seems to be no need for this incentive for the gifts to charities. The State is spending a large portion of its revenue for purposes that heretofore were charitable and it would seem that it is not unreasonable to collect some of these sums on gifts now exempt under Sec. 28 of the inheritance tax law.

Recommendation No. 6: The following rates are recommended for the categories as indicated.

It is difficult to justify any particular tax rate for any given purpose. One must weigh the following factors in setting a tax rate:

1. Revenue required.
2. Effect of the tax on market decisions respecting the location of economic activity.
3. Sources of wealth.
4. Tax competition with other states.
5. Economic burden on recipients.
6. Social factors.

An analysis of the tax rates and exemptions of the other states as set out in Table 6 indicates that the suggested rates are not out of line economically with other states and would not create hardship for the recipients of the property. The tax would not be a major factor in the selection of domicile by a person with wealth. They would substantially increase the revenue from the tax. In the report of the Advisory Commission heretofore referred to, an analysis of the inheritance taxes of the various states are made. On page 52 in an estate of $200,000, in which half goes to the wife and half to two children, 26 states would receive a larger share of the estate than did Illinois. A similar analysis was made of a $1,000,000 estate and 13 states would receive a larger share of the estate than Illinois. Thus an increase in the Illinois rates may be economically feasible. It should be remembered that widows would be given an additional $10,000 tax free for a savings of $200.

Recommendation No. 7: In taxing life estates and contingent remainders, actual events which occur prior to the tax determination should be used in computing the value of the life estate.

If a gift is to a wife for life and remainder to her children, the life estate is taxed on the full life expectancy of the wife, even though she may die one week later. If the contingency in fact occurs prior to the determination of the tax, no valid reason exists for taxing the beneficiaries on amounts other than those actually received.

Recommendation No. 8: Life estates with a power in the life tenant to invade should be taxed as a fee simple with a right of redetermination of the tax upon the receipt of the remainder by the remainderman.

The problems of life estates and remainders and powers of appoint-

Beneficiaries	Exceeding	Blocks in Net Estate not Exceeding	Amt. of Blocks	Rate Percent
Widow		25,000	25,000	2
Widower	25,000	50,000	25,000	3
	50,000	75,000	25,000	4
	75,000	100,000	25,000	5
	100,000	150,000	50,000	6
	150,000	200,000	50,000	7
	200,000	250,000	50,000	8
	250,000	300,000	50,000	9
	300,000	350,000	50,000	10
	350,000	400,000	50,000	12
	400,000	500,000	100,000	14
	500,000	1,000,000	500,000	16
	1,000,000	—	—	20
Minor Child	—	25,000	25,000	3
Adult Child	25,000	50,000	25,000	4
	50,000	75,000	25,000	5
	75,000	100,000	25,000	6
	100,000	150,000	50,000	7
	150,000	200,000	50,000	8
	200,000	250,000	50,000	9
	250,000	300,000	50,000	10
	300,000	350,000	50,000	12
	350,000	400,000	50,000	14
	400,000	500,000	100,000	16
	500,000	1,000,000	500,000	18
	1,000,000	—	—	20
Son-in-law	—	15,000	15,000	3
Daughter-in-law	15,000	30,000	15,000	4
Widow of son	30,000	50,000	20,000	5
Widower of	50,000	70,000	20,000	6
Daughter	70,000	100,000	30,000	8
Parents	100,000	200,000	100,000	10
Brothers	200,000	300,000	100,000	12
Sisters	300,000	400,000	100,000	14
Grandchild	400,000	500,000	100,000	16
Grandparent	500,000	1,000,000	500,000	18
	1,000,000	—	—	20

ment under the present inheritance tax law are discussed by Professor J. Nelson Young in Volume No. 4, 1961 Winter, University of Illinois Law

Beneficiaries	Exceeding	Blocks in Net Estate not Exceeding	Amt. of Blocks	Rate Percent
Nephews	—	5,000	5,000	5
Nieces	5,000	15,000	10,000	6
Aunts	15,000	30,000	15,000	8
Uncles	30,000	50,000	20,000	10
Cousins	50,000	75,000	25,000	12
Collaterals	75,000	100,000	25,000	14
	100,000	200,000	100,000	16
	200,000	300,000	100,000	18
	300,000	500,000	200,000	20
	500,000	1,000,000	500,000	25
	1,000,000	—	—	30
Friends	—	10,000	10,000	10
	10,000	30,000	20,000	12
	30,000	50,000	20,000	14
	50,000	75,000	25,000	16
	75,000	100,000	25,000	18
	100,000	150,000	50,000	20
	150,000	250,000	100,000	25
	250,000	500,000	250,000	30
	500,000	—	—	36
Charities	—	5,000	5,000	2
	5,000	10,000	5,000	3
	10,000	20,000	10,000	4
	20,000	30,000	10,000	5
	30,000	50,000	20,000	6
	50,000	70,000	20,000	7
	70,000	100,000	30,000	8
	100,000	150,000	50,000	9
	150,000	250,000	100,000	10
	250,000	500,000	250,000	15
	500,000	1,000,000	500,000	20
	1,000,000	—	—	25

Forum, pp. 694-709. A life estate with a power to invade the corpus with a gift over on the death of the life tenant is taxed only as a life estate. If the gift over is to a charity, the value of the remainder is computed by subtracting the value of life estate from the total value of the property. Under the current law, it would seem that the remainder may not be taxed even though the charity may actually receive nothing due to the invasion of the corpus by the life tenant. Moreover, it seems that the invasion

TABLE 5

State Gift Tax Rates and Exemptions For Selected Categories Of Donees, July 1, 1957

State	Wife	Donor's Lietime Exemption				Rates				Annual Exclusion to Each Donee
		Minor Child	Adult Child	Brother or Sister	Other than Relative	Spouse Or Minor Child	Adult Child	Brother or Sister	Other than Relative	
California*	$24,000	$12,000	$ 5,000	$2,000	$ 50	2-10%	2-10%	5-15%	7-10%	$ 4,000
Colorado*	20,000	10,000	10,000	2,000	500	2-8	2.8	3-10	7-16	2,500 spouse, child 1,500 brother, sister 1,000 other than relative
Louisiana*		30,000				2-3	2-3	5-7	5-10	5,000 spouse, child 1,000 brother, sister 500 other than relative
Minnesota†	10,000	10,000	5,000	1,000		.75-9	.75-9	2.25-27	3.75-45	3,000
North Carolina* .	25,000	25,000	25,000			1-12	1-12	4-16	8-17	1,000
Oklahoma								1-10		3,000
Oregon		10,000						1.5-12		5,000 spouse, child 1,000 other than relative
Rhode Island ...		25,000						1-7		4,000
Tennessee*, ¶						1-7	1-7	5-15	5-15	10,000 spouse, child‡ 5,000 brothers and sisters, others‡
Virginia*	5,000	5,000	5,000	2,000	1,000	1-5	1-5	2-10	5-15	
Washington*		10,000§				.9-9	.9-9	2.7-18	9-22.5	3,000
Wisconsin*, ¶, • ..	15,000	2,000	2,000	500		2-10	2-10	2-10	8.40	1,000

SOURCE: Compiled from Commerce Clearing House *Inheritance, Estate and Gift Tax Service.*
*Gift tax rates are the same as inheritance tax rates except in Washington where they are 90 percent of inheritance tax rates.
†The tax may not exceed 35 percent of the full value of the gift.
‡Only one annual exclusion is allowed each class of donees. One class includes spouse, lineal ancestor or descendant; all others are in the other class. Exemptions are deductible from the first bracket.
§Only one exemption allowed each class of donees. Spouse, lineal ancestors and descendants comprise one class; brothers and sisters another; all others, the third class.
¶Exceptions are deductible from the first bracket.
•In addition, an emergency tax is imposed equal to 30 percent of the tax computed at rates shown. Total tax may not exceed 15 percent of the value of the gift.

would not be taxed in the estate of the life tenant as an exercise of the power of appointment because the provisions on powers of appointment are applicable only where exercised for the benefit of someone other than the donee of the power. Thus, there is a question as to whether the wife could exercise the power to invade, give the property away and avoid the tax as well as the charity. Taxing the interest as a fee with a right to obtain a refund when the remainder actually passes does not impose hardship on the beneficiaries. For additional reasons and illustrations, see Professor Young's article.

Recommendation No. 9: The administration of the tax should be transferred to one central agency, preferably the Department of Revenue. The amount of the tax could be determined in the first instance by administrative action and in the event of disagreement, each taxpayer would have a right of judicial review in the Probate Court where the estate is being probated or if no probate, in the county where the deceased was domiciled or where the property was located. Jurisdiction of the county court should be limited to those counties which do not have a Probate Court.

Under the present law, the executor or administrator of the estate or other person files a tax return in duplicate with the clerk of the county or administration. One copy of this return is then sent to the Attorney General for examination. The other copy remains on file with the County Clerk and all interested parties are given notice of a hearing which is set by the County Judge. The Attorney General reviews the return and if additional information is required, he notifies either the person who has submitted the return or the Assistant Attorney General for the applicable area who gathers the additional information. The Attorney General after being satisfied as to the tax due, authorizes his assistant in the area to agree to the entry of an order determining the tax. A hearing is had in the county court with the County Judge acting in an administrative capacity and the return is approved or disapproved and an order is entered determining the tax. In the event either party is dissatisfied with the tax as determined, they have a right to appeal to the same County Judge acting in a judicial capacity. It should be noted that in counties with a Probate Court, the proceeding is in a different court (County Court) which has no other connection with the estate.

The taxpayer pays the tax to the County Treasurer who in turn forwards the money to the State Treasurer. The County Treasurer issues a receipt which is eventually signed by the State Treasurer and ultimately filed back in the estate in the Probate Court. As is noted in a prior section, the county receives 4 percent of the total tax for administering the hearing and collecting the tax. In a no-tax estate the county receives $5.00.

It is obvious that the current method of tax collection is not only cumbersome but is also a costly procedure. The Attorney-General's office in

Springfield employs at least 20 people reviewing the tax and there are approximately 60 special assistant attorneys general located in downstate Illinois. In addition there is an office in Cook County with a large staff and there are several special assistant attorneys general in Chicago who work on nothing but inheritance tax matters. Finally there are clerks in the county clerk's office, county treasurer's office and state treasurer's office involved in the collection of taxes.

The federal estate tax is reviewed initially by the Internal Revenue Service and if found to be satisfactory a simple letter is sent out from the District Director indicating approval of the tax. This letter is filed in the probate proceedings by the executor or administrator. If real estate is involved a release of the federal estate tax lien may be obtained.

There seems to be no valid reason for keeping the administration of the inheritance tax as a part of the functions of the Attorney General. The Attorney General could assist in the hearings in court in the event the amount of the tax to be paid is disputed but this would only involve a very small number of cases. In most cases the amount of the tax to be paid is agreed upon by the parties. An administrative determination of the tax with a right of judicial review on the part of any party who is dissatisfied would be constitutional and would protect the interested parties. It would eliminate the necessity for taking up the valuable time of county judges, county clerks and county treasurers. In addition the 4 percent of the tax which is now in the county would be turned over to the State. While county governments are from time to time in need of additional funds, it is objectionable to raise county funds by means of service charges on state taxes. While no actual budget is maintained for the cost of administering the inheritance tax, by the Attorney General, it is obviously substantial. The total cost could not be eliminated of course by transfer to the Department of Revenue but duplication of effort could be eliminated and uniform enforcement could be obtained by the review of returns in the Department of Revenue. This department would ultimately have a substantial file on valuations throughout the State and by using this information, together with the information obtained from the estate tax returns, valuations used in computing the tax could be equalized from county to county. In any event, judicial review of the tax should be by the Probate Court which has the complete records of the estate, and where no tax is due, the filing fee should be sufficient to cover the costs of the proceeding.

Recommendation No. 10: A copy of all death certificates should be filed by the undertaker with the inheritance tax authorities to provide a list of those persons who have died domiciled in Illinois.

It is believed that some estates which are subject to taxation are not being reported. For example, property may be held in joint tenancy in a bank or savings and loan institution. Believing no tax to be due, they may allow the transfer of funds on deposit without the required inheritance tax

consents. The estate may have real estate in addition to the bank account. It may not be sold for seven years and thus attorneys may approve the title to the real estate without a showing that inheritance tax has been paid. Many times the real estate stays in the same family for several generations and the question is not raised. Eventually, an affidavit may be made stating that there is no tax due by a person who does not in fact know that there was no tax due and the title to the real estate is accepted as clear. The net result is a loss of revenue because the question is never raised. Receiving a death certificate would provide a method of checking into estates where a tax may be due.

Recommendation No. 11: The statute should be so worded to provide specifically that expenses of the last illness which are paid after the date of death may be deducted from the inheritance tax but that the expenses of the last illness which were paid prior to death may not.

Payments prior to death have reduced the amount of funds on hand at date of death and therefore should not be deductible. The chief inheritance tax attorney in the Springfield Office indicates that he has a constant problem with deduction of expenses of the last illness which were paid prior to death. The current procedure attempts to follow this recommendation but the law needs clarification on this point in order to simplify administration.

CONCLUSION

Illinois should retain its inheritance tax until such time as there is a substantial change in the federal law and particularly the federal credit for state death taxes. The current law can be amended so as to provide increased revenue, eliminate current inequities, and provide for improved administration. It is estimated that 100 percent increase in revenue from death and related taxes might be realized, without economic complications or undue burdens, if the foregoing recommendations are adopted.

CHAPTER XVII

HIGHWAY-USER CHARGES

By Robert W. Harbeson*

Introduction

In recent years the State of Illinois has spent more for highways than for any other single purpose. It is not surprising, therefore, that the motor fuel tax and motor vehicle registration and related fees ranked second only to the general sales (retailers' occupation) tax as sources of tax revenue in this State. The relative importance of the various sources of State revenue in Illinois is shown in Table 1 of Chapter XI.

It may be noted in passing that the highway revenue and expenditure picture nationally is not greatly different from that in Illinois. For the states as a whole in 1960 highway expenditures were second only to those for education, while the motor fuel tax and motor vehicle registration fees ranked second and fourth, respectively, among individual sources of State tax revenue. The revenue from the latter two levies, taken together, exceeds that from any other single tax source.

Directly and indirectly user levies provide all but a small portion of the funds for State highway purposes in Illinois, a dominant portion of the revenue available to local urban governments for expenditure on roads and streets, and a smaller portion of the revenue available to local rural governments for road purposes. In the case of State highways, as shown in Table 1, 40.2 percent of the receipts are derived from the motor fuel tax, motor vehicle licenses, and road, bridge, and ferry tolls. Another 55 percent of the receipts represent a transfer of Federal highway funds, which in turn are derived from user levies paid into the Highway Trust Fund established in 1956. Finally, a substantial portion of the funds transferred to the State from cities is derived from locally imposed user levies. There were no State borrowings for highway purposes in 1960. Thus, altogether, between 95 and 96 percent of the receipts for State highways are provided directly or indirectly by highway users. As shown in Table 2, 48.3 percent of the receipts available to local urban governments for expenditure on roads and streets (excluding borrowings) represents a transfer of highway-user revenues from the State and another 32.2 percent is derived from locally imposed user levies, tolls, and parking meter charges, making a total of 80.5 percent derived from user sources. On the other hand, only 34.2 percent of the receipts available to local rural governments for road purposes, excluding borrowings) is derived from user sources, all but a negligible part of this amount representing a transfer of user revenues from the State.

In recent years all but a very small portion of the revenue from highway-user levies in Illinois has been devoted to highway purposes. Of a net

*The author is Professor of Economics at the University of Illinois.

total of \$250,516,000 received in 1960 from the motor fuel tax and motor vehicle registration and related fees only \$2,484,000 was used for non-highway purposes, and this amount was partially offset by \$582,000 appropriated from the State General Fund toward covering administrative costs. However, the Illinois General Assembly, on July 31, 1961, authorized a temporary loan of not to exceed \$34,000,000 by transfer from the Motor Fuel Tax Fund to the General Revenue Fund, if it became necessary in order to permit normal transactions in the General Revenue Fund. The amounts borrowed are to be repaid not later than June 30, 1964. As of June, 1963, one-half of the full amount authorized had been borrowed and the prospect of further borrowing was uncertain.

Analysis of the Motor Fuel Tax

A detailed statement of the motor fuel tax receipts in Illinois in 1960 is given in Table 3. Since 1953 Illinois has taxed motor fuel at the rate of 5 cents per gallon. As shown in Table 4, nine states, including Illinois, taxed motor fuel at this rate in 1961 and the remaining states at higher rates.[1]

TABLE 1

Sources of Revenue for State-Administered Highways in Illinois, 1960

	Amount (Thousands)
Motor fuel taxes	\$ 38,150
Motor vehicle licenses	70,562
Road, bridge, and ferry tolls	20,084
Transfers from Federal government	176,264
Transfers from local rural governments	9,613
Transfers from cities	3,535
Msicellaneous	2,482
Total	\$320,690

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics, 1960*, Table SF-3.

Illinois, in common with most other states, taxes diesel fuel at the same rate as gasoline. This policy, however, creates an inequity as between operators of gasoline-powered and diesel-powered vehicles. Studies sponsored by the United States Bureau of Public Roads and by others have demonstrated that gasoline-powered vehicles consume substantially more fuel per mile than diesel-powered vehicles of the same size operating under the same conditions. It follows that if gasoline and diesel fuel are taxed at the same rate the diesel-powered vehicls will not contribute toward meeting

[1] The states taxing motor fuel at the same rate as Illinois in 1961 were Arizona, Delaware, Hawaii, Kansas, Minnesota, Missouri, Texas, and Wyoming. In Hawaii the fuel tax rate is 8 cents per gallon in Hawaii County and 5 cents per gallon in the other counties.

highway costs the full amount required for vehicles in a given weight bracket. The disadvantage of gasoline-powered vehicles as compared with diesel-powered vehicles in fuel consumption, as shown in Table 6, may average as much as 50 percent. However, if allowance is made for variations in operating conditions and for the limitations of the fuel consumption test studies the average disadvantage may be more nearly 33 to 40 percent.

TABLE 2

Sources of Highway Revenue of Local Rural and Local Municipal Governments in Illinois, 1959

	Amounts (Thousands) Local Rural Governments	Local Municipal Governments*
Property taxes and special assessments	$ 47,702	$ 13,520
Appropriations from general funds	4,095	5,537
Local highway-user imposts-rural	—	—
Local highway-user imposts-urban	—	30,429
Tolls	132	6,309
Parking meter fees	—	1,951
Miscellaneous local revenue-rural	741	—
Miscellaneous local revenue-urban	—	4,281†
Transfers from urban places	—	—
Transfers from rural governments	—	—
Transfers from state-highway-user imposts	27,434	57,996
Transfers from state-other	9	—
Transfers from Federal government	81	7
Borrowings	60.584	34,403
Total	$140,778	$154,433

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics*, 1960, Tables LF-1 and UF-1.
*Partially estimated.
†Includes $996,000 traffic fines.

TABLE 3

Motor Fuel Tax Receipts in Illinois, 1960
(In Thousands)

Gross tax collections	$167,036
Deductions by distributors for expenses	3,341
Gross receipts by state	163,695
Refunds paid	19,850
Net receipts by state	143,845
Motor fuel inspection fees	970
Total net receipts	144,815

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics*, 1960, Table G-1.

TABLE 4

State Gasoline Tax Rates as of August 1, 1961*

Rate Per Gallon of Gasoline (cents)	Number of States
8	1†
7.5	1
7	16
6.5	4
6	19
5.5	1
5	9

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics*, 1960, Table G-205.
*Except in Missouri, where effective date was October 13, 1961.
†8 cents per gallon in Hawaii County and 5 cents per gallon in other counties.

TABLE 5

Motor Fuel Tax Rates of States Having Separate Taxes on Diesel Fuel as of August 1, 1961

	Rate Per Gallon of Gasoline (cents)	Rate Per Gallon of Diesel Fuel (cents)
California	6	7
Iowa	6	7
Kansas	5	7
Mississippi	7	8
Montana	6	9
New York	6	9
South Dakota	6	7
Texas	5	6.5
Vermont	6.5	None†
Wyoming	5	7

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics*, 1960, Table G-205.
†Vermont levies an additional registration, or "equalization," fee on diesel-powered vehicles.

On this basis, with the present gasoline tax rate of 5 cents per gallon in Illinois, it would be necessary to impose a tax of 6½ or 7 cents per gallon on the highway use of diesel fuel in order to put operators of gasoline-powered and diesel-powered vehicles, on the average, on an equal basis with respect to fuel tax burdens. If a tax of 7 cents per gallon had been levied on the highway use of diesel fuel in Illinois in 1960 it would have produced additional revenue of about $1,900,000.[2] At the present time, as

[2] An alternative to an additional tax on diesel fuel would be to levy upon diesel-powered vehicles registration fees sufficiently higher than those on gasoline-powered vehicles of the same weight to compensate, on the average, for the lower fuel consumption of the diesel-powered vehicles.

TABLE 6

Factors Relating Gasoline Engine Fuel Consumption to Diesel Engine Fuel Consumption by Gross Vehicle Weight for Operation in Normal Service Under Substantially the Same Operating Conditions

Gross Vehicle Weight (pounds)	Ratio of Gasoline Engine Fuel Consumption to Diesel Engine Fuel Consumption
25,000	1.39
30,000	1.42
35,000	1.44
40,000	1.48
45,000	1.50
50,000	1.52
55,000	1.55
60,000	1.57
65,000	1.59
70,000	1.62
75,000	1.63
80,000	1.65
85,000	1.66
Average	1.54

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Final Report of the Highway Cost Allocation Study*, Table IV-D-1, p. 204. Slight adaptations have been made in the presentation of the original table.

shown in Table 5, nine states impose higher taxes on diesel fuel than on gasoline, and one additional state levies a higher registration fee on diesel-powered than gasoline-powered vehicles in lieu of taxing diesel fuel.

The cost of collecting the motor fuel tax is low and the experience in Illinois compares favorably with that in other states. The cost of collection in Illinois in 1960, including the cost of administering the motor fuel inspection law, was $736,000, or 0.51 percent of the net motor fuel tax receipts, as compared with a national weighted average cost of collection of 0.62 percent.[3]

The exemption and refund provisions of the Illinois motor fuel tax law do not differ greatly from those of most other states. Sales of motor fuel by one licensed distributor to another, sales to the Federal government, sales of fuel for use outside the State, and sales to local transit systems are exempted. The tax on motor fuel sold for private and commercial use for general non-highway purposes and for aviation, on fuel sold to county and local governments for non-highway use, and on fuel sold for use in other

[3] U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics, 1960*. Table G-3.

than motor vehicles in public contract work is subject to refund. The amount of motor fuel exempted plus the amount subject to tax refund in Illinois in 1960 was 12.7 percent of the total reported consumption, as compared with a weighted national average of 9.7 percent.[4] Of the total private and commercial consumption of gasoline for non-highway purposes in Illinois in that year 62.1 percent was for agricultural use and 30.3 percent for aviation.[5] The total private and commercial consumption of gasoline for non-highway purposes in Illinois was exceeded only by New York (572 million gallons in New York, 380 million gallons in Illinois), while the consumption for agricultural use in Illinois (235 million gallons) exceeded that of any other state by a substantial margin.

The relative amounts of motor fuel exempted or subject to tax refund by the states for alleged non-highway use in 1960 are shown in Table 7. In interpreting these figures it should be kept in mind that they reflect differences in the character of economic activity in the various states as well as differences in controlling statutory provisions and their administration. Thus the percentage of motor fuel subject to tax refund is low in some states partly because aviation fuel is taxed; on the other hand, the percentage subject to refund in Illinois is affected by the fact that the quantity of aviation fuel consumed, and subject to tax refund, is exceeded by only three other states. Likewise, since a predominant part of the motor fuel subject to tax refund is for agricultural use the states, such as Illinois, in which agriculture is relatively important will generally have a higher percentage of fuel subject to tax refund than the others. While differences in types of farming and in number and type of tractors used may largely account for differences in the reported agricultural use of motor fuel in the various states the magnitude of the amount involved in Illinois suggests that additional effort might be expended in the administration of the motor fuel tax law, to insure that the amounts subject to tax refunds comply in all cases with the intent of the statute.[6]

One of the most important policy issues arising in connection with the motor fuel tax and other highway user charges is the economically correct allocation of the proceeds of these levies among the different parts of the road system of the State. These levies are justified on the benefit principle of taxation, that is, as payments to cover the cost of special facilities provided for the benefit of particular classes of individuals, as distinct from governmental services provided for the collective benefit of the general public. However, the motor fuel tax has certain serious limitations as a device for assessing highway costs to users in proportion to the benefits received, one

[4] *Highway Statistics, 1960, op. cit.*, Table G-2.
[5] *Ibid.*, Table G-24.
[6] In this connection it is worthy of note that Iowa and Illinois, although having generally similar types of agriculture, show significant differences in the agricultural use of gasoline. The agricultural use of gasoline in Iowa in 1959 was 622 gallons per t actor and 9.33 gallons per acre of cultivated land; in Illinois the corresponding figures were 808 gallons per tractor and 12.36 gallons per acre. Philip H. Burch, Jr., *Highway Revenue and Expenditure Policy*, (New Brunswick, New Jersey: Rutgers University Press, 1962), pp. 52-53.

TABLE 7

Relative Amounts of Motor Fuel Exempted or Refunded for Alleged Non-Highway Use, 1960

Exempted or Refunded as Percent of Total Motor Fuel Consumed During the Year	States			
0-4.9	Alabama	Maine	New Mexico	Vermont
	Arkansas	Maryland	N. Carolina	Virginia
	Connecticut	Mass.	Pennsylvania	W. Virginia
	Georgia	N. Hamp.	Rhode Island	D. C.
	Kentucky	New Jersey	S. Carolina	
5-9.9	Arizona	Michigan	Oregon	Wyoming
	California	Mississippi	Tennessee	
	Delaware	Nevada	Texas	
	Indiana	Ohio	Utah	
	Louisiana	Oklahoma	Wisconsin	
10-14.9	Colorado	Minnesota	Washington	
	Idaho	Missouri		
	Illinois	New York		
15-19.9	Iowa	Kansas	Nebraska	
20-24.9	Montana			
25-29.9				
30-34.9	S. Dakota			
35-39.9	N. Dakota	Hawaii		
40-44.9				
45-49.9				
50-54.9	Alaska			

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics, 1960*, Tables G-240.

of these being that, for practical reasons, the tax must be uniform for the entire network of roads in a state whereas the cost per vehicle mile of supplying highway service varies greatly with the type and location of roads. Thus a main intercity highway built to high standards will have a high cost per mile of road but, because of high traffic density, is likely to show a low cost per vehicle mile, while a local rural road will have a low cost per mile but, because of very light traffic, a high cost per vehicle mile. Furthermore, for the most part the beneficiaries of these two types of roads are different individuals.

These facts point to two conclusions. First, a fuel tax rate which would provide adequate intercity highways would not be adequate to finance local

rural roads. Second, to the extent that the fuel tax revenue generated on the main intercity system is used to supplement the fuel tax revenue generated on local rural roads the connection between tax paid and benefit received is broken and the benefit principle is violated. The further consequence of the latter situation is that the local rural road system will be overdeveloped, and the main intercity systems correspondingly underdeveloped, in relation to traffic requirements, and there will be an uneconomical allocation of resources both as between different parts of the highway transportation system and between highway transportation and other forms of transportation.

In order to avoid this distortion in the allocation of resources it is suggested that fuel tax revenue be allocated to the various parts of the road system in proportion to the amount of fuel tax revenue generated thereon, and that the proceeds of motor vehicle registration and related fees and any so-called "third-structure" taxes be allocated to the various parts of the road system on the same basis. The data necessary to implement this policy have recently been collected by the United States Bureau of Public Roads in connection with its *Highway Cost Allocation Study.* In the case of those roads which, with a level of user charges adequate to cover user responsibility for the primary highway system, do not generate sufficient user-charge revenue to cover all costs the remaining costs should be covered out of local general tax revenue and/or special assessments.[7] The extent to which each of these latter sources of revenue is used is necessarily a matter of judgment concerning the degree to which local road and street costs are assignable to special beneficiaries. It is recognized that adoption of the foregoing policy may intensify the financial problems of many local governments, especially in view of their heavy reliance upon the general property tax. However, financial relief for local governments should take some form other than a subsidy from highway user-charge revenue, in view of the distorting effect which such a subsidy has upon the allocation of resources devoted to transportation.

We consider next the extent to which the allocation of fuel tax revenue in Illinois reflects the foregoing considerations. All fuel tax revenue, after deducting 2 percent of the gross receipts allowed to licensed distributors for handling, is paid into a Motor Fuel Tax Fund. The amount required to cover the cost of collection, administration, and refunds is next deducted, along with the sum of $50,000 per month which is paid into the Grade Crossing Protection Fund to cover the State's share of the cost of projects of this type. The remainder of the receipts is allocated as follows:

Road Fund, for expenditure by Division of Highways	35 percent
Municipalities	32 percent

[7] No opinion is here expressed concerning the relative merits of the various procedures which have been developed for measuring the share of the cost of the various road and street systems assignable to users and non-users respectively. The policy here suggested is applicable whatever procedure for determining user versus non-user responsibility may be adopted.

Counties, having less than 500,000 population .... 12 percent
Counties, having more than 500,000 population (Cook County) .... 11 percent
Townships, Road Districts, or Township Districts .... 10 percent

The share going to the counties is allocated to individual counties in proportion to the amount of motor-vehicle registration fees received from their residents during the preceding year. The share going to the municipalities is apportioned to the several municipalities in proportion to their population as determined by the last Federal Census. The allotment to townships is apportioned to the several townships in proportion to the mileage of township roads in each township.

The allocation of motor fuel tax revenue to the various road and street systems in the State is shown in Table 7, together with the estimated percentages of total fuel tax revenue generated on the respective systems in 1957, the latest year for which data are available. It will be observed that the percentage allocations shown in the table differ from the statutory allocations just mentioned. The difference arises from the fact that the statutory allocations represent the percentage of the fuel tax revenue received by each level of government, whereas in the table the statutory allocations have been adjusted by the U. S. Bureau of Public Roads to show the estimated amounts actually spent on each road and street system. The estimated percentages of total fuel tax revenue generated on each system were computed from unpublished studies of traffic volume and composition made by the Bureau of Public Roads in connection with its recent *Highway Cost Allocation Study.*

The table reveals a serious misallocation of fuel tax revenue in relation to benefits received by highway users, as measured by fuel consumption. State highways receive less than half the amount, county and local roads 2.78 times the amount; and city streets 1.23 times the amount to which they are entitled on the latter basis.[8] However, as will be shown later, the misallocation is somewhat reduced when consideration is given to the combined allocation of fuel tax revenue and receipts from motor vehicle registration and related fees.

For purposes of comparison, the allocation of fuel tax revenue to road and street systems in Illinois and adjoining states, along with the national average figures, is shown in Table 9. It will be noted that Illinois allocates a much smaller proportion to city streets than do most of the adjoining states. A similar result is shown when the Illinois allocations are compared with national average figures.

---

[8] Funds for city streets forming urban extensions of State highway systems are included in allotments for State highway purposes. It is relevant to note in this connection that a recent investigation of the extent of non-essential road mileage, based on engineering studies and considerations of area and rural population density, holds that of 102,328 miles of rural roads in Illinois in 1959, 13,000 miles are non-essential. Burch, *op. cit.*, pp. 98-99.

TABLE 8

Allocations of State Motor Fuel Tax Revenue to Road and Street Systems in Illinois, 1960
(Amounts In Thousands)

	Total	State Highways	County and Local Roads	City Streets
1. Fuel tax revenue available for distribution* ..	$143,632	$38,012	$45,606	$60,014
2. Percentage distribution by road system	100	26.4	31.8	41.8
3. Estimated percentage of fuel tax revenue generated on each road and street system, 1957	100	54.8	11.4	33.8
4. Fuel tax revenue allocated on basis of percentage of fuel tax revenue generated on each road and street system (line 1 multiplied by line 3) ...	143,632	78,710	16,374	48,548
5. Difference between actual allocation of fuel tax revenue and allocation shown in line 4		−40,698	+29,232	+11,466
6. Ratio of actual allocation of fuel tax revenue to allocation on basis of fuel tax revenue generated (line 1 divided by line 4)		48.3	278.5	123.6

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics, 1960*, Table G-3 and unpublished Bureau of Public Roads data.
*Net funds available for distribution less expenditures for State highway police and safety and non-highway purposes. The allocations shown in lines 1 and 2 differ from the statutory allocations. The latter represents the amount of fuel tax revenue received by each level of government, whereas in the table the statutory allocations have been adjusted by the Bureau of Public Roads to show the estimated amounts actually spent on each road and street system.

Analysis of Motor Vehicle Registration Fees

A detailed statement of receipts from motor vehicle registration and related fees in Illinois in 1960 is shown in Table 10.[9]

[9] In addition to the fees listed in Table 10 the Illinois Motor Carrier of Property Act requires fees ranging from $5 to $25 for the following: applications for, and renewals of, certificates to operate as common carriers and permits to operate as contract-carriers; appplications for "grandfather" rights; applications for amendments, sale or transfer, modification, or consolidation of operating authority; and applications for, and renewals of, registration of common or contract carrier authority to operate motor vehicles for the carriage of property in interstate commerce over Illinois highways. These fees are paid into a special motor vehicle fund to be used to defray the cost of administration of the Motor Carrier of Property Act, and amounts not needed for this purpose are to be used for repair and maintenance of State highways. Revenue from these fees totalled $730,494 in 1960 and $703,178 in 1961. No part of this revenue was available for highway purposes.

TABLE 9

Allocation of State Fuel Tax Revenues to Road and Street Systems in Illinois and Adjoining States, 1960

(Amounts In Thousands)

State	State Fuel Tax Revenue Available for Distribution*	Expended on State Highways		Expended on County and Local Roads		Expended on City Streets	
		Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Illinois†	$ 143,632	$ 38,012	26.4	$ 45,606	31.8	$ 60,014	41.8
Indiana	96,964	50,508	52.1	30,993	32.0	15,463	15.9
Iowa	58,006	34,804	60.0	19,114	33.0	4,088	7.0
Kentucky	57,469	53,542	93.2	3,927	6.8	—	
Missouri	43,375	43,324	99.9	51	.1	—	
Wisconsin	68,576	38,166	55.7	19,737	28.8	10,671	15.5
Total 48 states and D. C.	$3,157,355	$2,207,888	69.9	$654,441	20.7	$295,026	9.4

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics, 1960*, Table G-3.
*Net funds available for distribution less expenditures for park and forest roads, State highway police and safety, and non-highway purposes.
†For explanation of Illinois allocations see footnote to Table 8.

TABLE 10

Receipts of Motor Vehicle Registration and Related Motor Vehicle Fees in Illinois, 1960

Motor vehicle registration fees	
Passenger cars (including taxis)	$ 45,650,895
Trucks and buses—flat-weight fees	43,399,455
Trailers—flat-weight fees	1,400,542
Trucks, buses, and trailers—mileage-weight fees	136,853
Trucks and buses—mileage-weight minimum tax	2,635,920
Trailers—mileage-weight minimum tax	21,854
Motorcycles	147,933
Total registration fees	$ 93,393,454
Miscellaneous motor vehicle imposts	
Certificate of title fees	$ 1,848,190
Title search fees	18,465
Certificate of junking	36,238
Chauffeurs' license fees	955,853
Operators' license fees	5,566,293
Dealers' license fees	296,264
Used car dealers' license fees	21,692
Transfers—passenger cars	1,556,387
Transfers—trucks and buses	34,854
Flat-weight tax—foreign vehicles	—
Reclassifications	536,427
Transit permits	—
Duplicates—all kinds	215,873
Mileage tax penalties	—
Mileage tax permits	—
Miscellaneous*	1,221,416
Total miscellaneous imposts	$ 12,307,952
Total Receipts (Registration fees plus vehicle imposts)	$105,701,104

SOURCE: Illinois Division of Highways, Bureau of Research and Planning.
*Contains 1952 deficiencies collected in 1960 of $147,104 and payment of mileage-weight fees for 1959 of $132,564.

In contrast to the motor fuel tax the cost of collecting these fees is very substantial. For 1960, the last year for which data are available, this sum amounted to $12,709,000 in Illinois, equal to 12.1 percent of the receipts from these fees. This compares with a weighted average of 10 percent for the states as a whole. The cost of collection of motor vehicle

TABLE 11

Cost of Collection of Motor Vehicle Fees and Special Motor Carrier Taxes, 1960

Amount Expended on Collection as Percent of Total Receipts Available for Distribution	States*		
Not over 4.9	Alaska	Iowa	Rhode Island
	Arkansas	North Dakota	South Dakota
	Idaho	Oklahoma	
5-9.9	Florida	Montana	Texas
	Maine	Nebraska	Vermont
	Michigan	New Hampshire	Washington
	Minnesota	New Mexico	West Virginia
	Mississippi	Pennsylvania	Wyoming
	Missouri	Tennessee	
10-14.9	California	Kansas	Oregon
	Colorado	Kentucky	Utah
	Delaware	Maryland	Virginia
	Georgia	New York	Wisconsin
	Illinois	New Jersey	D. C.
	Indiana	Ohio	
15-19.9	Alabama	North Carolina	
	Arizona	South Carolina	
	Louisiana		
20-24.9	Connecticut		
25-29.9	Massachusetts	Nevada	

SOURCE: Computed from U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics, 1960*, Table MV-3.
*No data reported for Hawaii.

registration and related fees and special motor carrier taxes in individual states in 1960 is shown in Table 11.

It may be pointed out that not only is the cost of collection in Illinois well above the national average, but that it is well above the cost of collection in a number of states which, unlike Illinois, have various kinds of weight-mile taxes in addition to registration and related fees. The fact that the over-all cost of collection in these states is a lower percentage of receipts than in Illinois despite the substantial additional cost of collection which weight-mile taxes are alleged to involve suggests that it should be possible substantially to reduce the cost of collection in Illinois. Nor can the relatively high cost of collection in Illinois be explained entirely in terms of the

TABLE 12

Schedule of Registration Fees for Passenger Vehicles in Illinois
(Vehicles Carrying Not More Than Seven Passengers)

	Annual Fee
Gasoline or steam	
25 H. P. and less	$ 6.50
Over 25, not over 35 H. P.	10.50
Over 35, not over 50 H. P.	17.00
Over 50 H. P.	22.00
Electric	12.00

SOURCE: Commerce Clearing House, *State Motor Carriers Handbook, 1960*, p. 5131.

magnitude of the revenue collected. Of the six states, including Illinois, which had revenues of $99 million or more from registration and related fees in 1960 the cost of collection in Illinois, as a percentage of receipts, was exceeded by only one other state. If the cost of collection in Illinois were reduced to the weighted national average figure of 10 percent the annual saving would amount currently to more than $2,000,000.

The number of passenger cars (including taxis) registered in Illinois in 1960 was 3,312,800, and the registration fees applicable to these vehicles totalled $45,650,895, or 48.9 percent of the total vehicle registration fees collected in Illinois in that year. The structure of registration fees for passenger cars in Illinois is shown in Table 12. It should be noted that Illinois permits registration on a half-year basis at one-half of the annual fee, so that the average amount paid by vehicles in the various classifications is less than the amount of the annual fee. This arrangement applies not only to passenger cars but also to trucks, buses, and trailers, except those taxed on a mileage-weight basis and those subject to special registration fees.

The basis for registration of passenger cars in individual states is shown in Table 13. It will be observed that Illinois is one of only four states which base the registration fee exclusively upon horsepower, while three other states use horsepower in combination with other factors. Eighteen states charge a flat fee and one additional state a flat fee varying with the age of the vehicle. All of the other states except Oklahoma base the fee upon either empty or gross weight or a combination of one of these with other factors. The diversity in the bases of registration used by the various states, as well as the nature of the bases used, is explainable largely by the circumstance that in some states the registration fee is used as a device for collecting all or part of the property tax applicable to the vehicles, while in others, including Illinois, it is treated solely as a means of recouping those adminis-

TABLE 13

Bases for Registration of Passenger Cars

Flat fee only

Alabama	Louisiana	Utah
Alaska	Nebraska	Vermont
Arizona	Nevada	Virginia
California	Ohio	Washington
Connecticut	Oregon	Wisconsin
Kentucky	Pennsylvania	Wyoming

Flat fee by age

Idaho

Empty weight or shipping weight

Colorado	Michigan	Tennessee
Delaware	Montana	Texas
Florida	New Jersey	West Virginia
Georgia	New York	District of Columbia
Hawaii	North Carolina	
Maryland	South Carolina	

Empty weight and horsepower

Indiana

Empty weight, value, and age

Iowa

Gross weight

Kansas
New Hampshire
Rhode Island

Gross weight and horsepower

Arkansas

Factory delivered price and age

Oklahoma

Empty weight and age

Minnesota
New Mexico
North Dakota
South Dakota

Horsepower groups

Illinois
Maine
Massachusetts
Missouri

Flat fee, horsepower, gross weight and age*

Mississippi

SOURCE: Adapted from table in U. S. Department of Commerce, Bureau of Public Roads, *Road-User and Property Taxes on Selected Motor Vehicles, 1960*, p. 2.
*Mississippi is reported, in practice to use empty rather than gross weight.

trative and highway costs assignable to a given class of vehicle which are not recovered through fuel taxes or other highway user taxes.

In general, the obligations of owners of motor vehicles with respect to property taxation and highway user taxation should not be confused through being intermingled in a registration fee. The registration fee should be

fixed at a level which, when combined with the fuel tax and other user charges, will discharge the highway cost obligations assignable to the class of vehicle in question. The use of horsepower as a basis for the registration fee is not satisfactory for this purpose, since it does not measure in any close and consistent manner the relative highway cost responsibilities of different vehicles. Weight is the logical basis to use for this purpose, but since the range of weight for automobiles is no greater than in many of the weight brackets used for the assessment of bus and truck registration fees a flat fee related to an average weight for automobiles would be appropriate and would, in addition, have the merit of administrative simplicity. The considerations supporting this conclusion are well stated in the following:

> "States which do not use the registration tax in lieu of ad valorem property tax may well consider the use of a flat registration fee for private passenger cars. Differences in dimensions, weight, and speed within the private passenger car group are not great enough to occasion measurably different highway construction or maintenance costs, and differences in mileage are reasonably well reflected in gasoline tax payments. The primary purposes of the registration charge on this type of vehicle are to cover certain administrative costs fairly allocable on a per-vehicle basis and to provide a 'ready for service' charge to defray some part of the cost of the highways. These purposes are adequately served by the flat fee."[10]

It might be contended that the foregoing conclusions are subject to qualification by reason of the emergence and growing popularity of small, light-weight European and American cars. However, no modification of the flat fee basis is needed unless and until a significant difference in highway cost responsibility as between the small and standard-sized cars is established. It is worthy of note in this connection that although the Bureau of Public Roads in its recent extensive *Highway Cost Allocation Study* collected data on three sizes of automobiles it presented figures covering cost responsibility only for the medium-sized cars, commenting that "The important issues with respect to comparative tax payments lie between passenger cars and the heavier vehicle groups."[11] A flat fee of $13.78 would have produced the revenue actually obtained from passenger car registration fees in 1960. However, it is again emphasized that the amount of the flat fee, if adopted, should take account of the fuel taxes and other user charges paid by operators of automobiles, to the end that this class of highway user meets its assigned cost responsibility on a basis comparable with that of other classes of highway users. For comparative purposes the amounts of property taxes and user charges collected from owners of various classes of motor vehicles in Illinois, and the position of Illinois relative to other states with respect to the amounts of these levies, is shown in Table 14. Unfortunately

---

[10] U. S. Board of Investigation and Research, *Report on Carrier Taxation*, House Document 160, 79th Congress, First Session (Washington, D. C., Government Printing Office, 1944), p. 211.

[11] U. S. Department of Commerce, *Final Report of the Highway Cost Allocation Study*, House Document 54, 87th Congress, First Session (Washington, D. C., Government Printing Office, 1961), p. 16.

TABLE 14

Rank of Illinois With Respect to State Road-User and Personal Property Taxes on Selected Classes of Motor Vehicles, 1960

Road-User Taxes Include Registration Fees and Estimated Annual Fuel Tax Payments

Class of Vehicle	Property Tax	State Road-User Taxes	Total	Rank of Illinois: Road-User Taxes	Rank of Illinois: Total Fees and Taxes
Very light passenger car	$ 30.17	$ 23.15	$ 53.32	47	16
Medium-weight passenger car	35.39	48.65	84.04	32	14
Heavy passenger car	78.97	61.30	140.27	32	11
Pickup truck, 5000 lbs.					
farm	20.23	44.00	64.23	24	13
private	29.24	57.50	86.74	37	19
Stake truck, 15000 lbs.					
farm	30.28	133.80	164.08	2	1
private	43.77	176.60	220.37	16	10
contract carrier	43.77	223.65	267.42	30	24
Single-unit van, 19000 lbs.					
private	79.16	259.00	338.16	17	6
contract carrier	79.16	325.65	404.81	30	21
Single-unit 3 axle dump truck, 40000 lbs.					
private	153.66	1,015.00	1,168.66	6	4
Tractor—semitrailer 3 axle combination, 40000 lbs.					
private	117.34	1,040.00	1,157.34	8	6
contract carrier	117.34	1,040.00	1,157.34	15	12
Four-axle semitrailer, gasoline-powered, 55000 lbs.					
private	166.70	1,640.00	1,810.70	11	12
contract carrier	166.70	1,640.00	1,810.70	22	20
Four-axle semitrailer, diesel-powered, 55000 lbs.					
private	227.23	1,439.45	1,666.68	10	10
contract carrier	227.23	1,439.45	1,666.68	15	14
Five-axle semitrailer, diesel-powered, 62000 lbs.					
private	273.79	1,883.70	2,157.49	10	10
contract carrier	273.79	1,883.70	2,157.49	15	14
Five-axle semitrailer, diesel-powered, 72000 lbs.					
private	292.42	1,952.95	2,245.37	10	9
contract carrier	292.42	1,952.95	2,245.37	14	11

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Road-User and Property Taxes on Selected Motor Vehicles, 1960*, Tables 4 to 14, inclusive.

TABLE 15

Registration of Trucks, Buses, and Trailers in Illinois, 1960

Weight Group (pounds)	Trucks and Buses: Flat Weight Basis Number	Flat Weight Basis Percent	Mileage Weight Basis Number	Mileage Weight Basis Percent	Total Number	Total Percent	Percent Mileage Weight Vehicles of Total
3000 and less	2,536	0.6	—	—	2,536	0.5	0.0
3001-8000	258,724	57.6	9	0.1	258,733	55.7	0.0
8001-10000	23,851	5.3	101	0.6	23,952	5.2	4.3
10001-12000	17,436	3.9	388	2.5	17,824	3.8	2.2
12001-14000	16,854	5.8	686	4.4	17,540	3.8	3.9
14001-16000	19,146	4.3	2,686	17.1	21,832	4.7	12.3
16001-20000	27,020	6.0	4,487	28.6	31,507	6.8	14.2
20001-24000	17,114	3.8	2,211	14.1	19,325	4.2	11.4
24001-28000	2,638	0.6	545	3.5	3,183	0.7	17.1
28001-32000	1,794	0.4	413	2.6	2,207	0.5	18.7
32001-36000	1,333	0.3	322	2.0	1,655	0.4	19.5
24001-36000 (bus)	201	0.0	—	—	201	0.0	0.0
36001-41000	11,119	2.5	2,043	13.0	13,162	2.8	15.5
41001-45000	901	0.2	215	1.4	1,116	0.2	19.3
45001-50000	1,038	0.2	229	1.5	1,267	0.3	18.1
50001-59000	9,383	2.1	982	6.2	10,365	2.2	9.5
59001-72000	4,531	1.0	385	2.4	4,916	1.1	7.8
Govt. owned	26,817	6.0	—	—	26,817	5.8	0.0
Agricultural	1,603	0.4	—	—	1,603	0.3	0.0
Permanently mounted	4,676	1.0	—	—	4,676	1.0	0.0
No Fee	30	0.0	—	—	30	0.0	0.0
Total	448,745	100.0	15,702	100.0	464,447	100.0	3.4
Trailers							
2000 and less	110,794	70.0	—	—	110,794	70.0	0.0
2001-5000	5,137	3.2	16	11.0	5,153	3.2	0.3
5001-10000	1,593	1.0	20	13.8	1,613	1.0	1.2
10001-15000	442	0.3	6	4.2	448	0.3	1.3
15001-20000	468	0.3	17	11.7	485	0.3	3.5
20001-32000 / Over 32000	273	0.2	86	59.3	359	0.2	24.0
Additional semi-trailers	35,872	22.7	—	—	35,872	22.7	0.0
Govt. owned	1,161	0.7	—	—	1,161	0.7	0.0
Agricultural	2,342	1.5	—	—	2,342	1.5	0.0
Permanently mounted	88	0.1	—	—	88	0.1	0.0
No Fee	1	0.0	—	—	1	0.0	0.0
Total	158,171	100.0	145	100.0	158,316	100.0	0.09

SOURCE: Illinois Division of Highways, Bureau of Research and Planning.

it is not possible to determine the adequacy of the user charges currently collected in Illinois, inasmuch as no systematic study of the highway costs assignable to motor vehicles as a whole and to individual classes of vehicles has been made in this State since 1948.

If the horsepower basis for automobile registration fees is retained it should be revised to remove certain internal inconsistencies. For example, as the schedule stands the fee per horsepower for a 26 horsepower car is 40 cents while that of a 35 horsepower car is 30 cents; likewise, the fee for a 36 horsepower car is 47 cents per horsepower as compared with 34 cents for a 50 horsepower car and 43 cents for a 51 horsepower car. The schedule should be so designed as to result in fees which increase at least proportionately with horsepower, and which would therefore avoid the foregoing inconsistencies.

The number of trucks, buses, and trailers, by weight groups, registered in Illinois in 1960 is shown in Table 15 and the schedules of fees applicable to these vehicles in Tables 16 and 17. The amount of the registration fees collected on trucks, buses, and trailers licensed under the flat-weight tax, by weight groups, is shown in Table 18. Data are not available to show receipts from mileage-weight registrations according to weight classes but the total receipts from mileage-weight fees are shown in Table 10.

A graduated scale of registration fees for vehicles larger and heavier than automobiles is needed as a supplement to the fuel tax because the latter does not reflect differences in the number of ton miles per gallon of fuel, and hence in the amount of road usage, produced by vehicles of different weights. Heavy vehicles use more fuel per mile than passenger cars but less fuel per ton-mile. Hence, taken by itself, a fuel tax applied to all vehicles at a uniform rate per gallon discriminates in favor of the heavy vehicle; if ton-miles are taken as a measure of road usage heavy vehicles will show more road usage per dollar of fuel tax paid than will passenger cars. Stated otherwise, if the fuel tax is considered by itself highway services are priced to operators of heavy vehicles on a relatively lower basis than to operators of passenger cars. Therefore registration fees should be so adjusted as to compensate for this circumstance, to the end that the total user charges for each class of vehicle equal the share of highway cost allocable thereto.

As stated above, lacking a recent highway cost allocation study it is impossible to say to what extent this objective is currently achieved in Illinois. However, the recent extensive *Highway Cost Allocation Study* undertaken by the U. S. Bureau of Public Roads pursuant to Section 210 of the Highway Revenue Act of 1956 has made available data showing the share of the cost of the Federal-aid highway system allocable to various classes of motor vehicles on a nation-wide basis. While not directly applicable to the situation in Illinois these data nevertheless suggest the possibility that the total annual user charges paid by various classes of vehicles in this State may not in all cases reflect their relative highway cost responsibility. Altogether apart from this possibility it would be highly desirable to undertake a highway cost allocation study in Illinois, taking advantage of the data and techniques developed in connection with the Bureau of Public Roads study. It should be understood in this connection that there is no single

TABLE 16

Schedule of Fees for Motor Trucks, Buses, and Trailers Licensed Under Flat Weight Tax in Illinois

Gross Weight, Vehicle and Maximum Load (pounds)	Annual Flat Weight Tax, Including $5.00 Registration Fee
Trucks and Buses	
3000 and less	$ 10
3001-8000	20
8001-10000	46
10001-12000	67
12001-14000	86
14001-16000	106
16001-20000	159
20001-24000	256
24001-28000	365
28001-32000	475
32001-36000 (3 or more axles)	584
24001-36000 (intercity bus)	394
36001-41000 (3 or more axles)	640
41001-45000 (3 or more axles)	705
45001-50000 (4 or more axles)	789
50001-59000 (4 or more axles)	894
59001-72000 (5 axles)	1,139
City buses	2
Government-owned	2
Agricultural plate	5
Permanently mounted equipment	10
Trailers	
2000 and less	6
5000 and more than 2000	20
10000 and more than 5000	49
15000 and more than 10000	84
20000 and more than 15000	130
36000 and more than 20000	562
Additional semi-trailers	10
Government-owned	2
Agricultural plate	5
Permanently mounted equipment	5

SOURCE: Commerce Clearing House, *State Motor Carriers Handbook, 1960*, pp. 5132-32.

objectively correct method for determining the share of highway costs allocable to motor vehicles as a whole and to individual classes of vehicles. Various methods of cost allocation have been developed which yield sub-

TABLE 17

Schedule of Fees for Motor Trucks, Buses, and Trailers Licensed Under Mileage Weight Tax in Illinois

	Minimum Guaranteed Mileage Weight Tax	Maximum Mileage Allowed Under Guaranteed Tax	Mileage Weight Tax for Mileage in Excess of Guarantee (Mills Per Vehicle Mile)
3000 and less	$ 2.50	2000	2
3001-8000	7.50	2000	5
8001-10000	20.50	3000	9
10001-12000	31.00	3000	12
12001-14000	40.50	3000	14
14001-16000	50.50	4000	18
16001-20000	77.00	4000	20
20001-24000	125.50	4000	32
24001-28000	180.00	5000	36
28001-32000	235.00	5000	47
32001-36000 (3 or more axles)	289.50	5000	58
24001-36000 (intercity bus)	194.50	5000	200
36001-41000 (3 or more axles)	317.50	5000	64
41001-45000 (3 or more axles)	350.00	5000	70
45001-50000 (4 or more axles)	392.00	5000	78
50001-59000 (4 or more axles)	444.50	5000	89
59001-72000 (5 axles)	567.00	5000	114

SOURCE: Commerce Clearing House, *State Motor Carriers Handbook, 1960*, p. 5132.

stantially different results, and a choice between these is inescapably a policy decision.

The combination of a fuel tax and a flat registration fee for each class of vehicle cannot produce a completely equitable allocation of highway costs because the level of the registration fee must necessarily be established in relation to the average annual mileage run by vehicles in the respective classes. To the extent that there is variation in the mileage run by vehicles in a given weight class the burden of the registration fee is heavier for some vehicles than for others. This inequity might be corrected by treating the registration fee as a readiness-to-serve charge, analogous to the demand charge in some public utility rate schedules, and combining it with some type of axle-mile or weight-mile tax graduated with the size of the vehicle. As of 1960, nineteen states and the District of Columbia levied either a passenger-mile or some type of weight-mileage tax, commonly known as a third-structure tax, in addition to the registration fee. The total revenue from this source in 1960 was $69,744,000.[12] About two-thirds of this amount

[12] *Highway Statistics, 1960, op. cit.,* Table MV 2.

TABLE 18
Revenue from Registration Fees of Trucks, Buses, and Trailers Licensed Under the Flat Weight Tax in Illinois, 1960

Weight Group (pounds)	Trucks and Buses Fees	Percent of Total
3000 and less	$ 23,295	0.0
3001-8000	5,625,140	11.6
8001-10000	1,071,271	2.5
10001-12000	1,146,805	2.6
12001-14000	1,423,687	3.3
14001-16000	1,979,974	4.6
16001-20000	4,203,721	9.7
20001-24000	4,308,352	9.9
24001-28000	937,685	2.2
28001-32000	832,675	1.9
32001-36000	763,288	1.8
24001-36000 (bus)	78,603	0.2
36001-41000	6,871,360	15.8
41001-45000	615,817	1.4
45001-50000	803,596	1.8
50001-59000	8,228,376	19.0
59001-72000	5,000,779	11.5
Government-owned	53,634	0.1
Agricultural	8,015	0.0
Permanently mounted	23,380	0.1
Total	$43,399,455	100.0
	Trailers	
2000 and less	$ 626,118	44.7
2001-5000	94,630	6.8
5001-10000	74,357	5.3
10001-15000	35,658	2.5
15001-20000	58,500	4.2
20001-36000	148 087	10.6
Additional semitrailers	348,720	24.9
Government-owned	2,322	0.2
Agricultural	11,710	0.8
Permanently mounted	440	0.0
Total	$ 1,400,542	100.0

SOURCE: Illinois Division of Highways, Bureau of Research and Planning.

represented collections in New York, Ohio, and Oregon, and six other states collected $1 million or more each.

The use of actual ton-miles would be theoretically preferable for a tax of this type but administrative considerations dictate the use of an axle-mile

or declared-loaded weight basis. Even the latter are alleged to involve relatively high collection costs, additional costs of record-keeping and reporting on the part of vehicle operators, and, in some instances, interstate reciprocity problems. It should be pointed out, however, that the over-all cost of collection of motor vehicle registration and related fees and special motor vehicle taxes in states making use of some kind of third-structure tax compares favorably with that in other states. In 1960 the over-all weighted average cost of collection in the states in question was 9.9 percent of total receipts as compared with a weighted national average of 10 percent and 12.1 percent in Illinois.

Consideration might well be given to the desirability of adding some kind of third-structure tax in Illinois, but such action should not be taken without careful weighing of the administrative problems involved and thorough study of the experience of other states with this type of tax. If a tax of this sort should be adopted the schedule of registration fees should be so adjusted as to insure that the total annual user charges paid on each class of vehicle do not exceed the share of highway cost allocable thereto.

An unusual feature of the Illinois motor vehicle registration fee structure is the provision of an option to license trucks and buses under either a flat-weight or mileage-weight schedule of fees. An examination of Table 15 shows that only 3.4 percent of the trucks and buses are registered under the mileage-weight option; however, 12.5 percent of the trucks and buses weighing over 36,000 pounds and 8.9 percent of those weighing over 50,000 pounds are so registered. Of the vehicles licensed under the flat-weight tax only 28.8 percent weight over 14,000 pounds, whereas of the vehicles registered on the mileage-weight basis 92.4 percent were in this category.

The mileage-weight option is inequitable and should be abolished. Since the flat-weight fee for vehicles in any given weight class is necessarily related to the average mileage run by these vehicles it is to the advantage of owners of vehicles making substantially less than such average mileage to register under the mileage-weight option, after taking account of the extra cost involved in posting a $500 bond, keeping records, and making the required reports. There is, of course, no inequity in the mere fact that these vehicles pay a lower tax based on their lower mileage; on the contrary, as just indicated, there would be merit in levying a mileage tax on all buses and trucks. The inequity arises from the fact that under the present arrangement only a small proportion of the vehicles are taxed on this basis while the great majority pay a flat-weight tax which, (1) because it is necessarily related to average mileage, results in some vehicles being relatively over-taxed and others under-taxed, and (2) which must be on a higher level than would otherwise be the case in order to offset the concession secured by the mileage-weight vehicles. The additional amount which operators of mileage-weight vehicles would have paid in 1960, if they had registered under the flat-weight schedule, was $2,319,120. In the absence of a cost

TABLE 19

Allocation of Receipts from Motor Vehicle Registration and Related Fees to Road and Street Systems in Illinois, 1960
(Amounts In Thousands)

	Total	State Highways	County and Local Roads	City Streets
1. Receipts from motor vehicle registration and related fees expended on roads and streets.*	$75,925	$55,088	$11,867	$ 8,970
2. Percentage distribution by road system.	100	72.5	15.7	11.8
3. Estimated percentage of fuel tax revenue generated on each road and street system, 1957.	100	54.8	11.4	33.8
4. Receipts from motor vehicle registration and related fees allocated on basis of percentage of fuel tax revenue generated on each road and street system (line 1 multiplied by line 3). ..	75,925	41,607	8,655	25,663
5. Ratio of actual allocation of registration and related fees to allocation on basis of fuel tax revenue generated (line 1 divided by line 4).		132.4	137.1	35.0

SOURCE: U. S. Department of Commerce, *Highway Statistics, 1960,* Table MV-3, and unpublished Bureau of Public Roads data.
*Net funds available for distribution less expenditures for State highway police and safety and non-highway purposes.

study it is impossible to say to what extent the mileage-weight option has resulted in heavier burdens on vehicles registered on the flat-weight basis and to what extent, if any, it has resulted in an over-all deficiency in the amounts collected from all vehicles in each of the weight classes.

The mileage-weight option also gives rise to inequities in connection with the reciprocity agreements which Illinois has with other states. Truckers who pay a relatively small mileage tax in Illinois nevertheless receive the full benefit of these reciprocity arrangements and thereby pay no

taxes or small taxes to the participating states. This is at the expense of other Illinois truckers whose taxes must be more than they otherwise would be to support their share of the reciprocity arrangements, and also at the expense of truckers in the participating states who must pay for highway service which is rendered to the Illinois mileage-weight trucks at no cost or less than full cost.

Motor vehicle registration fees are paid into the State Road Fund for expenditure in accordance with legislative appropriations therefrom. Unlike the motor fuel tax, there is no statutory provision for sharing the revenue for registration fees with local governments. Except for an item representing debt service for local roads the amounts shown in Table 19 do not represent payments to local governments but that portion of the expenditure by the State Division of Highways on local roads and streets which, according to estimates of the United States Bureau of Public Roads, was financed by motor vehicle registration and related fees. With regard to the miscellaneous fees listed in Table 10, the certificate of title fees, title search fees, and fees for certificates of junking are paid into the State General Fund, while two-thirds of the revenue from operators' license fees is paid into the Driver Education Fund. The remaining revenue from the operators' license fees and the entire revenue from the other fees is paid into the Road Fund.

The allocation of the receipts from motor vehicle registration and related fees to the respective road and street systems of the State is shown in Table 19. In contrast to the allocation of fuel tax revenues, shown in Table 8, the bulk of the revenue from the motor vehicle fees is allocated to state-administered highways, so that the aggregate amount collected from these two types of charges is allocated more nearly in accordance with the benefit principle than is true of either levy considered separately. However, as shown in Table 20, there remains a substantial discrepancy between the allocation of the combined levies and an allocation in accordance with the benefits received by users of the various parts of the road and street system, as measured by the relative amounts of fuel consumed thereon. Thus, State highways receive only 77 percent of the amount, and county and local roads 2.29 times the amount, to which they are entitled on the latter basis. It would therefore be desirable to allocate both the fuel tax revenue and the receipts from motor vehicle registration and related fees in proportion to the relative amount of fuel consumed on the various parts of the road and street system.

For purposes of comparison, the allocation of the receipts from motor vehicle registration and related fees to road and street systems in Illinois and adjoining states is shown in Table 21, along with national average figures, and the allocation of the combined fuel tax revenue and receipts from motor vehicle fees in Table 22. It will be observed that, as in the case of fuel tax revenue considered separately, the proportion of the combined levies allocated to state highways in Illinois is smaller, and the proportion

allocated to city streets larger, than in the adjoining states, as well as by comparison with the national average figures.

Unfortunately, data are not available which would permit comparison of the allocation of user charges revenue to various segments of the road systems with the fuel tax revenue generated thereon in states other than Illinois. However, a comparison of these allocations with vehicle miles on the various segments of the road systems would not produce greatly different results, and, as shown in Table 23, a comparison of this sort can be made

TABLE 20

Allocation of Combined Motor Fuel Tax Revenue and Motor Vehicle Registration and Related Fees to Road and Street Systems in Illinois, 1960

(Amounts In Thousands)

	Total	State Highways	County and Local Roads	City Streets
1. Distribution of fuel tax revenue by road system.	$143,632	$ 38,012	$45,606	$60,014
2. Distribution of receipts from motor vehicle registration and related fees by road system.	75,925	55,088	11,867	8,970
3. Total, lines 1 and 2.	219,557	93,100	57,473	68,984
4. Percentage distribution, line 3.	100	42.4	26.2	31.4
5. Estimated percentage of fuel tax revenue generated on each road and street system, 1957.	100	54.8	11.4	33.8
6. Total lines 1 and 2 allocated on basis of percentage of fuel tax revenue generated on each road and street system (line 3 multiplied by line 5).	219,557	120,317	25,030	74,210
7. Ratio of actual allocation of amount in line 3 to allocation on basis of fuel tax revenue generated (line 3 divided by line 6).	100	77.4	229.6	93.0

SOURCE: U. S. Department of Commerce, *Highway Statistics, 1960*, Tables G-3 and MV-3, and unpublished Bureau of Public Roads data.

TABLE 21

Allocation of Motor Vehicle Registration and Related Fees to Road and Street Systems in Illinois and Adjoining States, 1960

(Amounts In Thousands)

State	Amount Available for Distribution*	Expended on State Highways		Expended on County and Local Roads		Expended on City Streets	
		Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Illinois	$ 75,925	$ 55,088	72.5	$ 11,867	15.7	$ 8,970	11.8
Indiana	35,180	18,325	52.1	11,244	32.0	5,611	15.9
Iowa	45,022	18,613	41.4	21,757	48.3	4,652	10.3
Kentucky	17,740	14,638	82.5	3,102	17.5	—	
Missouri	35,845	35,804	99.9	41	.1	—	
Wisconsin	34,159	19,011	55.6	9,832	28.8	5,316	15.6
Total 48 states and D. C.	$1,306,199	$913,607	70.0	$296,790	22.7	$95,802	7.3

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics, 1960*, Table MV-3.
*Net funds available for distribution less expenditures for park and forest roads, State highway police and safety, and non-highway purposes.

TABLE 22

Combined Allocation of Fuel Tax Revenues and Motor Vehicle Registration and Related Fees to Road and Street Systems in Illinois and Adjoining States, 1960

(Amounts In Thousands)

State	Amount Available for Distribution*	Expended on State Highways		Expended on County and Local Roads		Expended on City Streets	
		Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Illinois	$ 219,557	$ 93,100	42.4	$ 57,473	26.2	$ 68,984	31.4
Indiana	132,144	68,833	52.0	42,237	32.0	21,074	16.0
Iowa	103,028	53,417	51.8	40,871	39.7	8,740	8.5
Kentucky	75,209	68,180	90.7	7,029	9.3	—	
Missouri	79,220	79,128	99.9	92	0.1	—	
Wisconsin	102,735	57,177	55.6	29,571	28.8	15,987	15.6
Total 48 states and D. C.	$4,463,554	$3,121,495	69.9	$951,231	21.3	$390,828	8.8

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics, 1960*, Tables G-3 and MV-3.

*Net funds available for distribution less expenditures for park and forest roads, State highway police and safety, and non-highway purposes.

TABLE 23

Allocation of State User Charge Revenue to Road and Street Systems, 1960 Compared with Vehicle Miles, 1957, East North Central States

(Percents)

States	State Highways		County and Local Roads		City Streets	
	State User Charges*	Vehicle Miles	State User Charges*	Vehicle Miles	State User Charges*	Vehicle Miles
Illinois	42.4	52.5	26.2	11.6	31.4	35.9
Indiana	52.1	63.2	32.0	8.9	15.9	27.9
Ohio	61.0	54.4	26.1	13.6	12.9	32.0
Michigan	49.0	49.3	34.0	18.9	17.0	31.8
Wisconsin	55.6	47.6	28.8	25.8	15.6	26.6
Total	52.4	53.1	28.9	15.7	18.7	31.2

SOURCE: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics, 1960*, Tables G-3 and MV-3, and unpublished Bureau of Public Roads data.

*Net funds available for distribution less expenditures for park and forest roads, State highway police and safety, and non-highway purposes.

for the states in the East North Central Census Region. It will be observed that for state highways the correspondence between user charge allocations and vehicle miles is closest in Michigan, for county and local roads it is closest in Wisconsin, and for city streets it is closest in Illinois.

Federal-Aid Highway Finance in Relation to State Highway Finance

An analysis of the highway revenue and expenditure situation in Illinois would be far from complete if it failed to take account both of Federal-aid highway funds received by this State and of payments by highway users in Illinois of the Federal excises levied to finance these receipts. Two significant facts with regard to these receipts and payments are shown in Table 24. First, the Federal-aid highway funds received greatly exceed in amount the payments by Illinois highway users of the 4-cent Federal gasoline tax and other Federal excises by means of which the Federal-aid payments are financed. The difference, amounting to $49,114,000 in 1960, is a result of the apportionment formulas currently used in Federal-aid highway legislation and represents, in effect, a contribution to Illinois highway users from highway users in other states. It should be noted that the revised basis of apportionment adopted for the Interstate System beginning in 1960 may have the effect of reducing in subsequent years the discrepancy between the Federal-aid apportionments to Illinois and the amounts paid into Federal Highway Trust Fund by Illinois highway users. Second, it is reasonable to assume that the Federal highway-use excises paid by Illinois users were generated on the respective road and street systems of the State in about the same proportions as the State fuel tax revenue, whereas the Federal-aid funds were allocated in very different proportions, with nearly all applicable to state-administered highways.

As a result of the foregoing circumstances the combination of Federal-aid funds with state highway-user charges results in a substantially different allocation of revenues to the respective road and street systems than is the case when only state highway-user charges are considered. As compared with an allocation based upon the relative amount of fuel tax revenue generated on the respective road and street systems the inclusion of Federal-aid funds results in an over-allocation to state highways of about the same magnitude as the under-allocation shown when only the total of state highway-user charges is considered, a very much smaller, though still large, over-allocation to county and local roads, and a very much greater under-allocation to city streets. The details are shown in Table 25.

If the total of Federal-aid funds and state highway-user charge revenues are to be allocated in accordance with the relative amount of fuel tax revenue generated on the respective road and street systems the allocations of state highway-user charges, taken separately, would have to be changed from the basis shown in line 6 of Table 25 to approximately 21 percent for state highways, 16 percent for county and local roads, and 63 percent for city

streets other than urban extensions of state highways. However, for the year 1960 this basis of allocation would have necessitated the sacrifice of a portion of the Federal-aid funds allotted for state highways, since the amount resulting from a 21 percent allocation would have been smaller than the matching requirement for Federal-aid funds. Published data do not show the exact amount of the matching requirement for state-administered highways in Illinois, but the amount may be estimated at around $48 million in 1960, as compared with $46,471,000 which would have been allocated to state highways on the basis just mentioned. It should be noted that this situation may be different in the future as Federal-aid allotments change.

TABLE 24

Federal-Aid Highway Funds Received by Illinois and Amount of Federal Excises Assigned to Highway Trust Fund Paid by Highway Users in Illinois, 1960

(Amounts In Thousands)

	Total	State Highways	County and Local Roads	City Streets
1. Federal-aid funds received by Illinois.	$186,893	$176,264	$10,629	—*
2. Percentage distribution by road system.	100	94.3	5.7	—
3. Estimated amount of Federal excises assigned to Highway Trust Fund paid by highway users in Illinois.	137,779			
4. Estimated percentage of fuel tax revenue generated on each road and street system, 1957.	100	54.8	11.4	33.8
5. Allocation of Federal excises paid by Illinois highway users on basis of percentage of fuel tax revenue generated on each road and street system (line 3) multiplied by line 4).	137,779	75,503	15,707	46,569

SOURCE: U. S. Department of Commerce, *Highway Statistics, 1960*, Tables SF-1, E-7, E-8, and unpublished Bureau of Public Roads data.

*Funds for city streets forming urban extensions of Federal-aid primary and secondary systems are included in the allotments for those systems.

Although the allocation of state highway-user charges to road and street systems should reflect the availablity of Federal-aid funds if the total allocation of user-charge revenue is to be proportionate to the relative volume of use of the various segments of the road and street system it would doubtless be unrealistic to expect states to adopt this policy so long as it involved the sacrifice of any portion of the available Federal-aid allotments.

Conclusions

1. The present allocations of user charge revenues to the various road and street systems in Illinois do not reflect the relative benefits received by

TABLE 25
Allocation of Motor Fuel Tax Revenue, Receipts from Motor Vehicle Registration and Related Fees, and Federal-Aid Highway Funds to Road and Street Systems in Illinois, 1960
(Amounts In Thousands)

	Total	State Highways	County and Local Roads	City Streets
1. Distribution of fuel tax revenue by road system.	$143,632	$ 38,012	$45,606	$ 60,014
2. Distribution of receipts from motor vehicle registration and related fees by road system.	75,925	55,088	11,867	8,970
3. Distribution of Federal-Aid highway funds by road system.	186,893	176,264	10,629	—
4. Total, lines 1, 2, and 3. .	406,450	269,364	68,102	68,984
5. Percentage distribution of line 4 by road system.	100	66.3	16.7	17.0
6. Estimated percentage of fuel tax revenue generated on each road and street system, 1957.	100	54.8	11.4	33.8
7. Total, line 4, allocated on basis of percentages in line 6.	406,450	222,735	46,335	137,380
8. Ratio of actual allocations, line 4, to allocations based on fuel tax revenue generated (line 4 divided by line 7).	100	121.5	147.0	50.2

SOURCE: See Tables 8, 19, 20, and 23.

highway users from the respective systems. In particular, there is a heavy over-allocation of funds for county and local roads. The consequence is a serious misallocation of resources both as between different parts of the highway transportation system and as between highway transportation and other forms of transportation. It is suggested that an allocation of user charge revenues based upon the relative amount of fuel tax revenue generated on the respective road and street systems might best correct this situation. If Federal-aid be disregarded this basis of allocation would call for the distribution of approximately 55 percent of both the fuel tax revenue and receipts from motor vehicle registration and related fees to the state highway system, 11 percent to county and local roads, and 34 percent to city streets.

As a matter of information it may be noted that if Federal-aid funds for 1960 are taken into account the appropriate allocation of state highway-user revenues would be 21 percent to state highways, 16 percent to county and local roads, and 63 percent to city streets other than urban extensions of state highways. However, it would be unrealistic to expect the State to take account of Federal aid in allocating state user-charge revenues so long as this involved the sacrifice of a portion of the Federal-aid allotment, as would have been the case in 1960.

2. Provision should be made for review of the foregoing allocations at regular intervals, perhaps every five years, in order to insure that they reflect any substantial changes in the volume and/or composition of traffic on the various parts of the road and street system of the state.

3. In order to provide a satisfactory basis for the re-allocation of user charges as suggested in the foregoing paragraphs it is necessary that roads and streets be grouped into a limited number of classes which are homogeneous with respect to volume of traffic and function served. The Illinois Highway Code, enacted in 1959, undertook to eliminate overlapping road classifications by providing that all highways in the state be classified into one of four systems: the State highway system, the county highway system, the township and district road system, and the municipal street system. However, it is essential that steps be taken to make each of these systems homogeneous with respect to the criteria just mentioned.

4. In the interest of equity as between operators of gasoline-powered and diesel-powered vehicles, respectively, and in the interest of insuring that each class of vehicle contributes an amount of user charge revenue which covers the share of highway cost allocable thereto, diesel fuel should be taxed at a rate 33 to 40 percent in excess of that levied on gasoline. If a tax of 7 cents per gallon on diesel fuel had been in effect in Illinois in 1960 the additional fuel tax revenue would have been about $1,900,000.

5. In view of the magnitude of tax refunds for the agricultural use of motor fuel some additional effort might well be expended in the administra-

tion of the motor fuel tax law, to insure that these refunds conform in all cases with the intent of the statute.

6. Inasmuch as the cost of collection of motor vehicle registration and related fees as a percentage of receipts is substantially higher in Illinois than for the states as a whole a systematic study should be undertaken of methods whereby these costs might be reduced. If the cost of collection in Illinois, as a percentage of receipts, could be reduced to the weighted average national figure the saving currently would be more than $2,000,000 per year.

7. The present horsepower basis for passenger car registration fees is not a satisfactory measure of the share of highway cost responsibility allocable to automobiles and should be replaced by a flat fee. A flat fee of $13.78 would have produced the revenue actually obtained from passenger-car registration fees in 1960. However, the amount of the fee should be determined in consideration of fuel taxes and other user charges paid by operators of automobiles, to the end that this class of highway users meets its assigned cost responsibility on a basis comparable with that of other classes of highway users. If the flat fee is not adopted the empty weight, or shipping weight, basis would be preferable to the horsepower basis. If the latter basis is retained the present schedule should be revised to remove internal inconsistencies.

8. The mileage-weight option in registration of trucks and buses should be abolished in order to put all operators of vehicles of a given weight class on an equal footing, and in order to insure that each class of vehicles contributes in user charges an amount adequate to cover the share of highway costs allocable thereto. The additional amount which operators of mileage-weight vehicles would have paid in 1960 if they had registered under the flat-weight schedule was approximately $2,319,000. In the absence of a cost study it is impossible to say to what extent the mileage-weight option has resulted in heavier burdens on vehicles registered on the flat-weight basis and to what extent, if any, it has resulted in an over-all deficiency in the amounts collected from all vehicles in each of the weight classes.

9. Consideration might well be given to the desirability of adding some type of mileage tax for trucks and buses. However, before such action is taken a careful study should be made of the administrative problems involved and of the experience of other states with this type of tax. Furthermore, if such a tax is adopted the truck and bus registration fees should be so adjusted that the total user charge payments of each class of vehicle do not exceed the share of highway costs allocable thereto.

10. In order to implement the foregoing recommendations it would be highly desirable for the State of Illinois to undertake a comprehensive highway cost allocation study, taking advantage of the data and techniques developed in connection with recent Federal and state studies of a similar nature.

CHAPTER XVIII

GENERAL CORPORATION TAXES

By Ruth A. Birdzell*

Corporations, in common with other taxpayers, are subject to property taxes on their real property and tangible personal property levied by local taxing districts and to the sales-use tax levied by the state government. These taxes are discussed elsewhere. In addition, corporations in Illinois are subject to other fees and taxes which apply exclusively to firms having that form of organization: (1) fees for filing documents and issuing certificates, (2) license fees, levied by the state, (3) franchise taxes, also levied by the state, and (4) capital stock taxes, levied by the local taxing districts.

Filing and License Fees

Filing fees, license fees, and franchise taxes are levied and collected for the state by the Secretary of State under the provisions of the Business Corporation Act, originally enacted in 1919. The act distinguishes between domestic corporations (those chartered by the State of Illinois) and foreign corporations (those chartered by other states). However, the sections applying to the two groups are very similar.

Filing fees are usually $1, $5, or $20, depending on the service performed. In only one case is a higher fee charged—$50 when a charter amendment restates the articles of incorporation.

A domestic corporation pays license fees "for the privilege of exercising its franchise in this State." An initial license fee is paid at the time the corporation files its first report of issuance of shares; the fee is based on the dollar value of the entire consideration received by the corporation for its issued shares. An additional license fee is paid when additional shares are issued or whenever there is an increase in stated capital and/or paid-in surplus. An additional fee is also charged when merger or consolidation brings about an increase in stated capital and paid-in surplus (Sec. 128 of the Business Corporation Act). The bases for the additional fees are the increases in the dollar amount of stated capital and paid-in surplus (Sec. 129). All of the license fees are computed at the rate of one-twentieth of 1 percent (Sec. 130). Total license fees collected from domestic corporations during the biennium ended June 30, 1961, amounted to $527,105.

A foreign corporation pays license fees "for the privilege of exercising its authority to transact such business in this state as set out in this application therefor or any amendment thereto." An initial fee is paid by the corporation at the time of filing its application for a certificate of authority to operate in Illinois; additional fees are payable when the corporation increases the amount of the sum of its stated capital and paid-in surplus repre-

*The author is Research Assistant Professor, Bureau of Economic and Business Research, University of Illinois.

sented in Illinois and when a merger results in an increase in the amount of the sum of its stated capital and paid-in surplus represented in Illinois (Sec. 135). The base for the computation of the initial fee is the amount of the sum of the corporation's stated capital and paid-in surplus represented in this state; the base for additional fees is the increase in the amount of stated capital and paid-in surplus represented in Illinois. The amount represented in this state is determined by the proportion of the sum of (1) the value of all its property and (2) the gross amount of its business which is represented by the sum of (1) the value of its property located in this state and (2) the gross amount of its business transacted at or from places of business in Illinois (Sec. 136). As in the case of domestic corporations, license fees are levied at the rate of one-twentieth of 1 percent of the base (Sec. 137). The license fees of foreign corporations in the 1959-61 biennium totaled $496,785. Total license fees paid by domestic and foreign corporations amounted to somewhat less than 8 percent of the receipts of the Secretary of State's office from corporations.

Franchise Taxes

A domestic corporation pays an initial franchise tax at the time it files its first report of issuance of shares, an additional franchise tax when it reports an increase in its stated capital and/or paid-in surplus or when a merger or consolidation results in an increase in stated capital and paid-in surplus, and an annual franchise tax (Sec. 131). The initial tax and the annual tax are based on the amount of the sum of its stated capital and paid-in surplus represented in this state; when stated capital and paid-in surplus are increased in amount, the increase is the base for an additional franchise tax. The proportion of stated capital and paid-in surplus allotted to Illinois is determined as in the case of license fees: (Value of property located in Illinois + gross amount of business transacted at or from places of business in Illinois) ÷ (value of property everywhere + gross amount of business everywhere). There are some exceptions to this rule; for example, a corporation may elect to pay on the full amount of its stated capital and paid-in surplus, and if a corporation fails to file its annual report, the Secretary of State may compute the tax on the full amount of stated capital plus paid-in surplus (Sec. 132). The rate for franchise taxes on domestic corporations is one-twentieth of 1 percent of the base (Sec. 133). The law establishes minimum annual franchise taxes as follows (Sec. 134):

Stated capital plus paid-in surplus	Minimum
$50,000 or less	$ 10
More than $50,000 but not more than $200,000	15
More than $200,000 but not more than $500,000	20
More than $500,000 but not more than $1,000,000	50
More than $1,000,000 but not more than $10,000,000	200
More than $10,000,000	500

It is plain that the minimum becomes a smaller fraction of the base as the size of the corporation increases. At $50,001 the minimum is 0.03 percent of the base, at $200.001 only 0.01 percent, and at $10,000,000 only 0.002 percent. The rate of one-twentieth of 1 percent reduces to a decimal of 0.05 percent. Thus the minimum at $10,000,000 is only a twenty-fifth of what it would be if a flat rate were levied. At a straight rate of one-twentieth of 1 percent, a corporation having stated capital and paid-in surplus of $500,000 would pay a franchise tax of $250 instead of $20, and a corporation with stated capital and paid-in surplus of $10,000,000 would pay $5,000 instead of $200. This favoring of the larger corporations is generally attributed to a wish to avoid discouraging large enterprises from incorporating in Illinois.

Sections 138, 139, and 140 make provisions for foreign corporations similar to those made for domestic corporations by Sections 131, 132, and 133. However, Section 140½, which established the same graduated minimum annual franchise taxes for foreign corporations that Section 134 did for domestic corporations, was held unconstitutional by the Illinois Supreme Court in *St. Louis Southwestern Railway Co.* v. *Stratton*, 353 Ill. 273 (1933), and is therefore not followed by the Secretary of State's office. Only the $10 minimum is applied.

Annual franchise taxes are computed on the basis of reports filed with the Secretary of State. These reports are to include, among other things, the number of authorized shares, the number of issued shares, and the amount of stated capital and paid-in surplus. A corporation also indicates whether it elects to pay a franchise tax based upon its entire stated capital and paid-in surplus. If it does not so elect, it must indicate the total dollar value of all the property of the corporation, the total dollar value of property located in Illinois, the gross amount of business transacted everywhere, and the gross amount of business transacted at or from places of business in Illinois. It is a fairly simple matter to compute the tax liability on the basis of these figures. Since no complete financial reports are required or submitted, the Secretary of State's office is in no position to check the last four figures mentioned. It must depend on the honesty of the corporation officers.

Thus it is possible for corporations to evade part of their franchise taxes simply by understating the proportion of their property and business in Illinois. In view of the fact that 75 to 80 percent of the corporations are reported to be paying the minimum tax, this may often be the case. The chief corporations which would be unable to escape part of their franchise tax in this manner would be the public utilities.

Inasmuch as the franchise taxes apparently paid by the majority of corporations are so low, it is scarcely worth while for them to try to avoid the tax altogether by failing to file an annual report. According to Section 82(a) of the Business Corporation Act, the penalty for such failure, or for failure to pay the taxes when due, could be involuntary dissolution. Alternatively,

the Secretary of State may assess the corporation on the basis of its full stated capital plus paid-in surplus and add a 10 percent penalty. If the tax levied is not paid by the due date, a penalty rate of 1 percent a month is to be added. The Secretary of State may also have the Attorney-General institute action to collect the tax due or may issue a warrant directly to the county sheriff for collection. In any case, so long as the taxes remain unpaid, the Secretary of State shall not "file any articles, statements, certificates, reports, applications, notices, or other papers," and no corporation "shall maintain any action at law or suit in equity until all such franchise taxes, license fees and penalties have been paid in full."

Revenue from Fees and Franchise Taxes

With the exception of two years, revenue from corporation fees and franchise taxes in Illinois has increased throughout the postwar period, reaching $6,871,785 in 1961. At that level, receipts from such fees and taxes were approximately double those in 1946, as is shown in Table 1.

In the 1959-61 biennium, domestic corporations paid fees and taxes of $7,540,712 (58 percent) and foreign corporations paid $5,453,393 (42 percent). Franchise taxes alone amounted to $6,295,799 for domestic firms and $4,796,484 for foreign corporations. The payments of foreign corporations have been increasingly important in the past 15 years—in 1946 they accounted for slightly less than 32 percent of the total and in 1959 for 41 percent. Between 1946 and 1959 the revenue from foreign corporations in-

TABLE 1

Revenue from Corporation Fees and Franchise Taxes in Illinois

Year	Domestic Corporations	Foreign Corporations	Total
1946	$2,375,272	$1,103,286	$3,478,557
1947	2,437,887	1,239,694	3,677,581
1948	2,393,969	1,367,341	3,761,310
1949	2,445,662	1,363,137	3,808,799
1950	2,587,950	1,398,174	3,986,124
1951	2,535,169	1,483,559	4,018,728
1952	2,730,738	1,629,335	4,360,073
1953	2,692,961	1,655,599	4,348,561
1954	2,904,725	1,688,268	4,592,992
1955	3,116,761	1,797,773	4,914,534
1956	3,219,204	2,246,583	5,465,787
1957	3,235,228	2,214,503	5,449,731
1958	3,401,707	2,304,193	5,705,900
1959	3,559,991	2,491,564	6,051,555
1960	......	......	6,430,762
1961	......	......	6,871,785

SOURCE: Illinois, Office of the Secretary of State.

creased 125 percent but that from domestic corporations rose only 50 percent. Thus it appears that foreign corporations are becoming more important in the Illinois economy.

It also appears, paradoxically, that foreign corporations pay larger annual taxes and fees, on the average, than domestic corporations do. Annual averages in the most recent years for which data are available ranged from $60 to $65 for domestic corporations and between $270 and $285 for foreign corporations. Inasmuch as about two dozen public utilities pay a fairly large proportion of the total, the remaining domestic firms pay, on the average, even less than $60 to $65.

No data are available about the fees and taxes paid by individual corporations, except that the largest payments are made by public utilities. This is to be expected since the utilities have all or nearly all of their property and do all or nearly all of their business within the state and have large amounts of stated capital and paid-in surplus. The two largest taxpayers in the most recent year were Illinois Bell (more than $362,000) and Commonwealth Edison (more than $311,000).

There seems to be a difference of opinion as to whether the franchise tax is intended to be a fee or to be a revenue-producing tax. It is not a fee since the cost of the Corporation Division of the Secretary of State's office is only slightly more than 4 percent of the revenue taken in, of which franchise taxes constitute the major source. But neither is it an important source of revenue for the state government. Receipts of the Secretary of State's office from corporations in recent years have accounted for less than 1 percent of total annual state tax collections; in 1962 corporation taxes paid to the state amounted to only seven-tenths of 1 percent of state tax collections.

One reason for the relatively minor yield is the narrow base on which the tax is levied—stated capital plus paid-in surplus. In many lines of business these two elements may account for no more than half of the capital involved, with surplus reserves, earned surplus, and undivided profits accounting for half or more than half. According to United States Treasury Department data, this is true of mining, where the value of stock plus paid-in surplus accounts for 50 percent of net worth; construction, 45 percent; manufacturing, 44 percent; wholesale and retail trade, 46 percent; finance, insurance, and real estate, 50 percent; and all industrial groups, 50 percent. Only in three industrial groups is the proportion greater than 50 percent: agriculture, forestry, and fisheries, 69 percent; transportation, communications, and utilities, 64 percent; and services, 57 percent. Thus the inclusion of earned surplus and undivided profits would double the yield of the franchise tax in total and in some industries would more than double the yield. If the worth of the corporation is the measure of the value of its franchise, it is very difficult to justify the exclusion of earned surpluses from the base for the franchise tax.

The inclusion of earned surplus and undivided profits in the base for the franchise tax is by no means uncommon. Eight states, including Ohio, make earned surplus and/or undivided profits a part of the base.

The comparatively low rate also helps to explain why the yield of the Illinois franchise tax is such a small proportion of total tax collections. More than half the states which use a combination of stated capital, paid-in surplus, earned surplus, and undivided profits levy their franchise taxes at higher rates than the one-twentieth of 1 percent levied in Illinois. The rates in use in these states vary, of course, but the range of rates runs from two times as high as the Illinois rate to eight times as high. About half of this group—that is, a fourth of the states with franchise taxes based on the four specified components of worth—not only have the higher rates but also base their taxes on all the components, including earned surplus and undivided profits. Thus they charge rates up to six times higher than the Illinois rate on bases which may be twice as large as the base used in Illinois.

Practice in Other States

The base, rate, and yield differences are marked in comparison with other states which levy similar franchise taxes. Table 2 gives information on bases, rates, and yields for Illinois and 11 other states. It should be noted that not all of the other 11 states are industrialized but nearly all of them receive more revenue as measured by dollars and all of them receive a higher proportion of total state tax collections from corporation franchise taxes, chiefly because of broader bases or higher rates or both.

It should not be thought that these states have substituted higher franchise taxes for other taxes. As Table 3 shows, corporations are generally subject to the same variety of taxes as they are in Illinois, plus income taxes in several instances.

Besides the taxes shown in the table, domestic corporations in Alabama pay a stock tax, corporations in Louisiana pay a power use tax, Michigan corporations pay a business receipts tax, and in Pennsylvania, corporations are liable for an excise tax. In all the states, miscellaneous other taxes and fees are collected from corporations. The eight states which levied corporate income taxes received revenues as shown in Table 4.

In addition to these states, two other states may be mentioned as presumptive competitors of Illinois as business locations. Both of these states base their franchise taxes on net income. California bases its franchise tax on the net income derived from or attributable to sources within the state and levies the tax at a rate of 5.5 percent (with a minimum of $100). In 1962 the state collected $290,797,000 from this source and an additional $1,415,000 from corporations as filing and qualification fees, a total of $292,212,000, or 12.3 percent of state tax collections. In New York the franchise tax is measured chiefly by net income, which is apportioned on the basis of real and tangible personal property, receipts, payrolls, and invest-

TABLE 2

Franchise Tax Bases, Rates, and Yields, 12 States

State	Subject Corporations	Base	Rate (Percent)	Yield, 1962: Amount (000 Dollars)	Yield, 1962: Percent of Total State Tax Collections
Alabama	Domestic Foreign	Authorized capital stock Actual amount of capital employed in state	.25	9,118*	3.1
Illinois	Domestic and foreign	Apportioned share of stated capital plus paid-in surplus	.05	6,744†	0.7
Louisiana	Domestic and foreign	Apportioned share of issued and outstanding capital stock, surplus, undivided profits, and borrowed capital	.15	15,198*	3.1
Michigan	Domestic and foreign	Apportioned share of paid-up capital and surplus	.5	60,339*	6.0
Mississippi	Domestic and foreign	Apportioned share of issued and outstanding capital stock, surplus, undivided profits, and true reserves	.25	3,573*	1.7
Missouri	Domestic and foreign	Apportioned share of par value of outstanding shares and surplus	.05	6,219*	1.6
North Carolina	Domestic and foreign	Apportioned share of issued and outstanding capital stock, surplus, and undivided profits.	.15	9,000*	1.7
Ohio	Domestic and foreign	Apportioned share of issued and outstanding shares of stock (= book value of capital, earned and unearned surplus, undivided profits, and certain reserves)	.1 and .3‡	52,034†	5.8
Oklahoma	Domestic and foreign	Apportioned share of outstanding capital stock, surplus, and undivided profits, plus debt of more than 3 years' duration	.125	3,447*	1.1
Pennsylvania	Foreign	Apportioned share of capital stock (except investment in manufacturing plant and business)	.5 and 1.0§	20,073*	1.5
	Domestic¶	Actual cash value of capital stock (based on market value of stocks, earnings, and book value of assets)	.5 and 1.0§	42,149	3.2
Tennessee	Domestic and foreign	Apportioned share of issued and outstanding capital stock, surplus, and undivided profits	.15	8,550*	2.6
Texas	Domestic and foreign	Apportioned share of stated capital, surplus, and undivided profits, plus debt of more than 1 year's duration	.225	55,375†	5.9

SOURCE: For bases and rates, Commerce Clearing House, *State Tax Guide, All States*, 2nd edition; for yield data, U. S. Bureau of the Census, *Detail of State Tax Collections in 1962*, G-SF62-No. 4, and *State Tax Collections in 1962*, G-SF62-No. 3.

*Corporation franchise taxes only.

†Total revenue from corporation license fees and franchise taxes.

‡Investment companies and state-chartered banks pay at the rate of .1%; others pay the .3% rate.

§Distilling companies pay 1%; others pay .5%.

¶Domestic corporations pay a "capital stock" tax instead of a franchise tax.

ment income. The rate is 5.5 percent and the minimum is $25. In 1962 this franchise tax produced $218,328,000. Total taxes and fees from corporations were $222,320,000, 9.5 percent of total state tax collections.

Even if the capital stock tax in Illinois were a state tax rather than a local tax, the total revenue from that tax and the franchise tax would probably be no more than $30 million, perhaps 3.3 percent of total state tax collections. This is still well below the lowest level found in other industrial states. It is difficult to make direct interstate comparisons, but it seems fairly clear that the Illinois franchise tax is well below that of other states using similar bases, even states which are less industrialized. It also appears

TABLE 3

Other Taxes for Which Corporations are Liable

State	Other Corporate Taxes			
	Income Tax	Sales Tax	Use Tax	Property Tax
Alabama	x	x	x	x
Louisiana	x	x	x	x
Michigan		x	x	x
Mississippi	x	x	x	x
Missouri	x	x	x	x
North Carolina	x	x	x	x
Ohio		x	x	x
Oklahoma	x	x	x	x
Pennsylvania	x	x	x	x
Tennessee	x*	x	x	x
Texas		x	x	x

SOURCE: Prentice-Hill, *State and Local Taxes, All States Tax Guide*, Englewood Cliffs: Prentice-Hall, 1956).
*Excise tax based on net earnings.

TABLE 4

Corporate Net Income Tax Collections, Eight States, 1962

State	Amount (000 Dollars)	Percent of Total State Tax Collections
Alabama	$ 9.199	3.1
Louisiana	23,316	4.8
Mississippi	13,074	6.4
Missouri	12,000	3.0
North Carolina	56,796	10.5
Oklahoma	14,575	4.7
Pennsylvania	148,900	11.3
Tennessee	21,516	6.5

SOURCE: U. S. Bureau of the Census, *Detail of State Tax Collections in 1962*, G-SF62-No. 4, and *State Tax Collections in 1962*, G-SF62-No. 3.

that in general Illinois taxes corporations a good deal less severely than its most likely competitors do.

The Capital Stock Tax

Corporate firms are liable, too, for local taxes on their intangible personal property. Domestic firms are taxable on the total of their intangibles under the so-called capital stock tax which applies to the difference between the full going-concern value of the corporation and the value of its real estate and tangible personal property. Foreign corporations are generally liable to taxes on all their intangible property "which is located in this state and used in their business transacted within the state."[1] The law excepts foreign corporations which are required to pay a premium tax for the privilege of doing business in Illinois (insurance companies except fraternal benefit societies).

Despite its name, the capital stock tax is not a tax on the capital stock shares of a corporation. It is, rather, a tax on the corporate excess—the value of the corporation as a going concern in excess of the value of its tangible property. This excess value is usually considered as representing the intangible assets of the corporation; its assessment is, in fact, a substitute for the assessment of individual items of intangible property.

Provisions of the Law

The important provisions of the law and the court cases in which they have been tested are as follows:

(1) The capital stock tax shall apply to all corporations organized under the laws of the state of Illinois. *Porter* v. *Rockford, Rock Island, and St. Louis Railroad Company,* 76 Ill. 561 (1875). It does not apply to corporations chartered by other states. *Western Union Telegraph Company* v. *Lieb*, 76 Ill. 172 (1875). In the *Porter* case, the Illinois Supreme Court stated very plainly that the tax did not constitute double taxation; that opinion was reiterated in several other cases coming before the court in the years immediately after 1875. In the *Western Union* case, the court stated that although there was no doubt of the power of the legislature to tax foreign corporations, additional legislation would have to be passed if such application were desired.

(2) Companies "organized for purely manufacturing and mercantile purposes, or for either of such purposes, or for the mining and sale of coal, or for printing, or for the publishing of newspapers, or for the improving and breeding of stock" or as banks or savings and loan associations are assessable on the value of their capital stock by local assessors; all other corporations are assessable by the Department of Revenue. The division of jurisdiction was upheld in *Coal Run Coal Company* v. *Finlen*, 123 Ill. 666 (1888). Complete exemption of any class was barred in *Consolidated Coal Company of St. Louis* v. *Miller,* 236 Ill. 149 (1908).

---

[1] *Illinois Revised Statutes, 1961,* Ch. 120, Sec. 499.

(3) The value of the capital stock (corporate excess) of a corporation shall be listed in the taxing district wherein its principal office or place of business is located. The very wide discretion left to the corporations in their choice of their principal place of business was upheld in *Illinois Water Service Company* v. *Champaign County,* 367 Ill. 641 (1938).

(4) The Department of Revenue shall adopt rules not inconsistent with law for ascertaining the fair cash value of capital stock. The use of indebtedness as a factor in determining the value of a corporation was upheld by the court in the *Porter* case; and in *Chicago Union Traction Company* v. *Board of Equalization,* 114 Fed. 557 (1902), both indebtedness and earnings were required to be considered in arriving at capital stock values. In *J. B. Inderrieden Company* v. *Lindheimer,* 370 Ill. 316 (1939), the court upheld the use of the total value of intangibles as the minimum value of the corporate excess.

(5) When a person refuses to make out a personal property schedule, the assessor shall list the property according to his best knowledge and judgment and shall add a penalty of 50 percent to the valuation of the property so listed. *Pacific Hotel Company* v. *Lieb,* 83 Ill. 602 (1876).

(6) "All intangible personal property of foreign corporations [except some insurance companies] doing business in this state which is located in this state and used in their business transacted within the state" shall be taxed. Such taxation was upheld in *People* v. *McGraw Electric Company,* 375 Ill. 241 (1941).

Present Administration: Department of Revenue

Because of the split in jurisdiction over assessment of capital stock values, it is necessary to examine separately the administration of the law by the Department of Revenue and administration by local assessors.

In 1934, the Tax Commission estimated that about two-thirds of the domestic corporations were under the jurisdiction of local assessors and only one-third were assessable by the commission. By 1947, the department's jurisdiction had expanded only slightly, to 36 percent of the domestic corporations. Since that time, however, a steadily increasing proportion of domestic firms has been assessable by the department. By 1959 and 1960, the proportion of domestic corporations assessable by the Department of Revenue was approximately 53 percent.

The division of jurisdiction leaves five major groups of corporations assessable by the department:

(1) public utilities (light, heat, power, telegraph, telephone, and water companies);

(2) service corporations (architectural, engineering, cleaning and dyeing, advertising, insurance agency, garage, undertaking, cemetery, real estate, safety deposit, brokerage, amusement);

(3) transportation corporations (bus; airline; steam railroad; street

railroad; express; pipeline; tank, sleeping car, and so on; taxi; trucking; ferry; steamboat; bridge);

(4) financial corporations (insurance, trust, personal finance, and investment, but excluding banks and building and loan associations); and

(5) mining corporations, except coal mining.

Methods

One method of valuing corporate capital stock is to base the assessment directly on the value of specific items of intangible property, such as cash and credits. Because such a measure does not include the value of the franchise and other tangible values not represented by identifiable property, the department uses it only in cases where other data are lacking. Such a method also fails to arrive at a value which compensates for underassessment of tangible property, where such underassessment occurs. In some cases, the value of the intangibles is taken as a minimum below which capital stock value may not fall. The view is taken that the corporate excess of a company cannot be less than the value of its intangible property. The department's more usual methods of valuing the corporation are (1) to average the market value of the shares and the capitalized net earnings or (2) to average the balance sheet value of the assets and the capitalized net earnings. The first of the two methods is generally usable only in the cases of large corporations where the stock is traded on exchanges. (Where bonds are traded on the market, their value is also to be based on the market value.) In the great majority of instances, there is no market value of shares and the balance sheet value of assets must be used.

The second factor in determining the value of the going concern is capitalized net earnings. Since some types of assets are excluded in the calculation of worth, the income from these assets must also be excluded in the capitalization of earnings. Five years' incomes are used whenever possible. It is thought that recent earnings are more indicative of the company's worth than earlier income; therefore the department prescribes a weighted averaging. The most recent year is given a weight of 3, the next most recent year a weight of 2, and each of the other three years of the five-year period a weight of 1. The average weighted earnings are capitalized at rates varying from 7 to 21 percent, according mainly to the type of business and the degree of risk involved.

From conversations with people in the department, it is evident that not all corporations cooperate fully in supplying the data required for proper assessment of capital stock. The Property Tax Division uses an average of the fair cash value and capitalized returns, if both are available; if only one is available, that one is used. If neither is available, the division may use stated capital plus paid-in surplus as recorded in the Secretary of State's office as a guide. In any case, the division arrives at what is judged to be a fair figure for the full value of the corporation, then deducts the

equalized assessed values of real property and tangible personal property to arrive at the value of the corporate excess. Once that value has been determined, the department debases the figure to approximately 55 percent to keep its assessments on a par with assessments made locally.

In cases where corporations have been uncooperative about filing, the department frequently adds the 50 percent statutory penalty to encourage future filing of adequate information.

There is, of course, a limit to how far the department can go. It sometimes happens that when the capital stock assessment begins to come near to a fair figure or even merely exceeds what the company is willing to pay, the corporation simply incorporates in another state, dissolves the Illinois corporation, and thereby avoids the tax altogether. Where such an outcome appears likely, the department has to decide how far it can proceed toward the fair value of the corporate excess without prompting the firm to become a foreign corporation so that the entire value of its corporate excess is lost.

One of the most serious problems posed by the capital stock tax law is the proper (or adequate or equitable) assessment of large industrial plants. It must be remembered that public utilities are required by law to be Illinois corporations but that manufacturing corporations are free to avoid the capital stock tax by incorporating in some other state. Moreover, utilities are assessable on their capital stock by the Department of Revenue whereas (purely) manufacturing corporations are assessable by local officials; the department pursues a vigorous policy of assessment but local assessors often do not.

With regard to public utilities, it is likely that some of them do not have the proportion of intangible properties now represented by their capital stock assessments. It is well known that public utilities have very high proportions of fixed capital investment, yet their capital stock assessments are frequently a substantial percentage of their total assets. For example, the large utilities in Illinois have between 90 and 94 percent of their total assets represented by utility plant alone;[2] that is, their investment in other physical properties such as office buildings, supplies, and materials is not included. But for some of the largest utilities, capital stock assessments represent from 12 to 30 percent of their total assets.

What generally happens is that local assessors in most counties make little or no attempt to value the physical properties of large corporations, including utilities. Instead they depend on the corporations to "give" them a "fair" value or a "good" value and accept the corporations' declarations practically without question. Company officials generally feel that they do declare "fair" values. "Fair," however, is not defined (or, for that matter, definable) in either case.

In some cases, the law, as it stands, puts a premium on the corporations' *not* declaring the full value of their physical properties in the expecta-

---

[2] According to data contained in *Moody's Public Utility Manual 1960.*

tion that the underassessment will be only partly caught in the capital stock assessment and that the capital stock assessment may well be taxable at a lower rate. For example, one utility has its general offices at Bloomington, where the total rate in 1960 was about $3 per $100, but its principal office is at Monticello, where the 1960 rate was approximately $0.79 per $100. The Bloomington rate is a good bit more typical of the rate payable in most tax districts.[3] A power company also has its principal office at Monticello, but its general offices are at Decatur, where the tax rate in 1960 was $3.75 per $100. The effect of a large capital stock assessment is plainly discernible —the rates in other towns and villages in Piatt County generally run three or four times as high as the Monticello rate. Obviously, so long as the law states that capital stock tax shall be paid in the district of the principal office it behooves corporations to declare assessed valuation accordingly.

Utility officials recognize that the assessment of capital stock at one office as is done at present is unfair to the other districts in which they do business. Some of them freely state that they would consider it much fairer if the capital stock assessed value were distributed according to the origin of the company's revenue. Moreover, utility officials do not feel that the distribution of assessed value would entail any great difficulty.

Assessments by the Department

In 10[4] of the 15 metropolitan counties of the state, the number of corporations assessed by the department rose each year or nearly every year, and the number assessed in 1960 was substantially higher than the number assessed in 1946. Another 22 counties, including the 5 remaining metropolitan counties, showed fluctuating totals and ended the period with increases which may be labeled "significant relative to size." A half dozen small counties either had the same number of corporations assessed in 1960 as in 1946 or had fewer firms with assessable capital stock value. The remaining 64 counties showed fluctuating totals with the total number higher, but not significantly so, in 1960.

The aggregate value of Department of Revenue assessments downstate more than doubled between 1946 and 1960, whereas the aggregate for Cook County was only about three-fourths higher in 1960 than it was in 1946.

In four counties of the state—Adams, Piatt, Tazewell, and Winnebago —aggregate assessments rose each year during the 1946-60 period and ended the period at a very much higher level. In two of these counties, of course, public utilities accounted for much of the total and for much of the increase. In eight other counties—Cook, DuPage, Ford, Knox, Lake, Livingston, Massac, and Wabash—the total of department assessments rose in all but one or two years and was very substantially higher in 1960 than in 1946. In Cook County the total rose by about 76 percent and the other

---

[3] The downstate average tax rate in 1960 was $3.05 per $100, and the Cook County rate was $4.56. The State average was $3.70, and the median rate was $3.02.

[4] Champaign, Cook, DuPage, Kane, Lake, Madison, Peoria, St. Clair, Will, and Winnebago. (The other 5 metropolitan counties are McHenry, Macon, Rock Island, Sangamon, and Tazewell.)

counties saw manifold increases in their totals. Another 35 counties showed fluctuating totals and ended the 15-year period with assessments which showed increases which were substantial but less striking than those in the preceding group. These counties were Champaign, Christian, Clark, Coles, Crawford, DeKalb, Douglas, Effingham, Fayette, Hancock, Henry, Iroquois, Kane, Kankakee, Kendall, LaSalle, Lawrence, Logan, McHenry, Macon, Macoupin, Madison, Marion, Mercer, Monroe, Peoria, Richland, Sangamon, Stephenson, Union, Vermilion, White, Whiteside, and Woodford.

At the other end of the scale 13 counties merely held their ground or even lost ground—Carroll, DeWitt, Gallatin, Hardin, Jefferson, JoDaviess, McDonough, Lee, Pike, Pulaski, Rock Island, St. Clair, and Will.

Mention has already been made of the importance of public utilities (usually power companies) in the Department of Revenue's aggregate assessed value of capital stock for some counties.[5] A better idea of the weight of public utilities can be obtained by comparing public utility values with total values of capital stock assessments in a few counties. In Adams County, the assessment of the Central Illinois Public Service Company accounted for more than 98 percent of the total capital stock assessments by the department. In Piatt County Illinois Power Company and General Telephone Company of Illinois together accounted for 99.8 percent of the total initial assessment by the Department of Revenue in 1960.[6] In Kane County, the initial assessment of Northern Illinois Gas Company accounted for 81 percent of the total. In Kankakee County a gas storage company accounted for 77 percent of the original assessments made by the department. Even in Cook County, where utilities, by numbers, are lost among the several thousand corporations assessed, it is estimated that utilities accounted for about 40 percent of the total capital stock assessment valuation.

It may be of interest to note the distribution of the department's assessments. Cook County, of course, accounted for a very large share, more than 41 percent. Piatt County, with virtually no industry but the principal offices of two large utilities, received nearly 22 percent of the department's total assessments for the state in 1960. Sixteen other counties having sizable public utilities accounted for another 29 percent in 1960. Only 8 percent of total department assessments was accounted for by the remaining 84 counties in 1960.

Yet another measure is the proportion of department-assessed capital stock certified to the metropolitan counties of the state. Of the 1960 total of $538,635,060, the 15 counties included in Standard Metropolitan Statistical Areas accounted for slightly more than 60 percent. This group did not, of course, include Piatt County, with its assessed valuation of $117,898,200.

---

[5] Virtually all of the companies assessed by the department for more than $1 million are public utilities. Three of five Cook County corporations and all of the 19 downstate corporations assessed for more than $1 million in 1960 were gas, electric, water, or telephone companies.

[6] These two companies together account for nearly half of the total property assessed valuation in Piatt County.

These data clearly show the effect of the provision of the law that the entire capital stock of a corporation shall be assessed in the county where the principal office is located.

Present Administration: Local Officials

In general, the method used by the Department of Revenue is also to be used by the local assessors. The actual work of assessing capital stock locally may be done by the township assessor or his deputy, the county assessor, the county supervisor of assessments, or the board of assessors, as the case may be. If none of these officials acts, then the board of review or the board of appeals is responsible for the assessment of capital stock. The Department of Revenue has no authority to assess, though it may act (and does act on occasion) as an adviser to the local assessing officials.

It is not known exactly how many local officials are concerned with the assessment of capital stock. It is known that there are 1,444 township assessors in the downstate counties having township organization. There are 17 counties organized on commission lines; these counties have county assessors—in most, but not all, of these counties, the county treasurer acts also as county assessor. In Cook County, a special section of the county assessor's office is solely concerned with the assessment of the capital stock of domestic corporations having their principal places of business in the county; and in St. Clair County, there is a board of assessors. Somewhat more than a third of the counties have county supervisors of assessments. And in each county there is a board of review or a board of appeals. Thus, whereas the capital stock of the 53 percent of domestic corporations under the jurisdiction of the Department of Revenue is assessed by one of a few persons, the capital stock of the 47 percent under the jurisdiction of local officials is valued by one or more of a small army of assessors. In the 17 counties having the commission form of government and in Cook County, the assessment *may* be done in a unified manner, inasmuch as there is, in each case, a single person in charge. In the township counties having a supervisor of assessments, assessment may or may not be unified, depending on who does it. If the supervisor, the board of assessors, or the board of review performs the task, the results may be fairly uniform within the county. If the township assessors do it, they are not obliged to accept any suggestions from the supervisor of assessments. In those counties which do not have a supervisor of assessments, the township assessors are unlikely to receive any unified direction, so far as capital stock is concerned at least. In such circumstances, it is difficult to see how the legislative and judicial requirement of uniformity is to be achieved.

During the latter part of 1960 an extensive study was made of the manner in which local officials assess the capital stock (corporate excess) values of corporations under their jurisdiction.

Counties Not Actively Assessing Capital Stock

At the time inquiries were made, it was found that in 70 counties nothing or virtually nothing was being done toward local assessment of corporate excess. In about half of these counties the lack of activity usually resulted in very low aggregate values of assessed capital stock or in no value. In other counties voluntary declarations of capital stock value by the corporations themselves were passively accepted by the local assessing officials, so that some assessed value was shown for capital stock.

Various reasons for inaction were given by those interviewed or could be deduced from their comments. In many counties the chief reason given was that the county was predominantly rural and there were no corporations having capital stock value or at least none worth making a special effort to assess. There were other reasons, of course. There was a fear of antagonizing the firms, which were "turning in pretty good values for personal property," and it was thought that realty and tangible personalty accounted for all or nearly all of the value of local corporations. One county assessor plainly labored under the mistaken idea that a corporation could never be worth more than its paid-in capital. Sometimes assessors did not know how to assess the tax and "it's never been done." In some of these counties the corporations had successfully advanced the idea that the tax constitutes double taxation despite the *Porter* decision to the contrary as long ago as 1875. In one county, the county assessor had even been convinced that the locally assessed value of tangible property should be subtracted from a Department of Revenue capital stock assessment instead of added to it.

It was learned that the double-taxation complaint has been particularly successful in the southeastern counties of the state and has perhaps been the most important reason for the generally poor showing of those counties with respect to capital stock assessments. The idea was not confined to that area, however. It at least partly accounted for the low valuations in an industrial county in the northeast. In that county the assessing official frequently, but not always, removed declared capital stock values, so that assessment was even more than usually arbitrary and fortuitous.

In several counties a belief was apparent that county and local assessing officials had nothing to do with capital stock assessments—that the Department of Revenue did it all. In some of these counties it was quite plain that those interviewed thought that local assessing activity was confined to real estate and tangible personal property. Some of these counties had supervisors of assessments, who should know better.

In one county, the only reason for nonassessment that could be obtained was that "the board of review won't go along" with the supervisor of assessments' wish to assess.

In a half dozen counties little or nothing was being done because the chief interest was in other elements of the tax base, specifically real estate.

In some counties practically exclusive attention was being given to completion of an inventory of real property. In one county a program of real estate equalization was under way and assessing officials chose not to jeopardize that program by antagonizing taxpayers—the people most certain to be subject to a capital stock tax were those already most opposed to the equalization program, which was considered much more important than capital stock assessment. In other cases in this group of counties, corporations were reluctant to file needed information and the tax was also considered unfair, because unincorporated businesses did not declare the value of intangibles.

In a few counties assessment was "mostly by custom," which was generally a euphemistic way of saying assessors carried the same values forward from year to year without regard for the altered situations of the firms. Sometimes it merely meant that the corporations declared their own values, which were accepted without question. Some of these values had originally been computed by a Department of Revenue consultant, and the same values were being declared each year.

In some instances little was done because officials took the view that when real estate and tangible personal property were properly assessed, there was nothing or very little to assess as capital stock.

Inability of the assessors to compute the tax was given as the most important reason for inaction in three of the largest downstate counties, two of which were metropolitan counties. In one of the three the supervisor of assessments commented that calculation of capital stock value practically required the talents of a certified public accountant. In another the statement was made that to assess capital stock would require the services of a full-time employee and the holders of the purse strings had consistently refused to provide for such a position.

In the remaining counties of this inactive group, no particular reason could be obtained for inaction, but it was abundantly plain in most of them that general ignorance of the law prevailed.

Counties with Active Assessment Programs

In contrast to the 70 counties just discussed, where capital stock assessment was at best a passive acceptance of declared valuations, tax assessing officials in 32 counties were active in trying to assess capital stock.[7] Generally these counties fell into one or the other of two sub-classes—those whose assessors followed the Department of Revenue formula (frequently with variations), and those whose assessors had their own ways of arriving at values of capital stock.

In 25 of these 32 counties the method being used was that suggested by the Department of Revenue for local assessors or some variation of it.

[7] Adams, Bureau, Cass, Champaign, Christian, Cook, DeKalb, DuPage, Ford, Grundy, Hancock, Kane, Kendall, Lake, LaSalle, Livingston, Logan, McHenry, McLean, Madison, Mason, Massac, Menard, Montgomery, Morgan, Ogle, Piatt, Randolph, St. Clair, Shelby, Stephenson, and Winnebago.

In most of these counties, assessments were being made by supervisors of assessments, county treasurers, treasurers' deputies, county assessors, boards of assessors, boards of review, or boards of commissioners; in only three counties were township assessors actually doing the work of assessing capital stock. In some places where local officials were technically making the assessments, valuations were actually being made by Department of Revenue consultants because local assessors did not feel qualified.

Local officials actually computing the value of capital stock in several counties adhered very closely to the procedures set forth by the department in its *Assessors' Manual* for local assessors. That is, they used an average of net assets and earnings capitalized at 7 percent when both these figures were available.

In another group of counties where the local assessing officials used the department formula to a substantial extent, the rate of return used for capitalization of earnings was varied according to one or more of several factors. These factors were business conditions, type of business, establishment of a new firm, and the occurrence of exceptionally good or bad years. As in the case of the department itself, the rate was varied from 7 to 21 percent. In one county a straight 10 percent rate was used, and in another a single rate of 20 percent was used for capitalization.

Once they had arrived at the value of the capital stock, however, some assessors departed from the department-prescribed method. The assessed value figure was reduced to proportions of the full fair value figure ranging from 10 to 65 percent. In a few counties the proportion was 50 to 55 percent, approximately the same as that of the department, but more often the percentage was lower.

Moreover, these counties did not all assess capital stock at the same proportion of full value as they did other classes of property. A county which assessed capital stock at 33 percent assessed other property at 51 percent; another which assessed capital stock at 50 percent assessed other types of property at proportions of full value ranging from 60 percent to 100 percent; and a third which assessed capital stock at 10 percent assessed other types of personal property at 40 to 45 percent and real estate at about 60 percent. The differential treatment was generally occasioned either by a desire to encourage the declaration of a "fair" value for corporate excess or by a desire not to penalize incorporated businesses relative to unincorporated firms.

In a few of the counties with active assessment programs, assessors were using balance sheet figures alone to a considerable extent, because corporations were reluctant to provide income data. As in other counties of this group, non-filers were usually assessed at what assessing officials considered fair, but penalties were rarely used except in cases where the corporations were extremely uncooperative.

Of the 32 counties where an effort was made to assess capital stock, 7 did not use the Department of Revenue formula.

Assessors in four of these counties depended very heavily on their own judgment. In two counties the board of review as a group went through the list sent out by the department and assessed each corporation for whatever amount the board members considered proper. The values were usually nominal so there were few if any protests. In a third county a member of the board of review did the assessing and usually set the value according to what the company was thought to be worth and in comparison with similar firms—the valuation was set so as to "keep everybody happy." In none of these counties did the corporations file the information needed to compute the value. In the last county of this group of four, the township assessors were primarily responsible for assessment, but their assessments were subject to review by a treasurer's deputy, whose review was, in turn, subject to further consideration by the board of review. In most cases the corporations did not file the pertinent information but simply entered a value on the first page of their tax return forms. Assessed values were then 10 percent or 20 percent of these declared values, the proportion evidently depending on the judgment of the treasurer's deputy. Then when these assessments reached the board of review, the board sometimes cancelled the debasement and assessed capital stock at the value originally declared by the corporations.

Assessors in a fifth county used a variety of methods. In one of three townships accounting for most of the capital stock assessments, the assessor accepted pretty much at face value the amounts declared by the corporations themselves. Capitalization of earnings was occasionally used to check the values in such cases as rental real estate. In a second township declared values might or might not be accepted at face value by the assessor; for companies which failed to declare a capital stock value, the assessor entered a value for capital stock which ranged from 7 to 10 percent of the total personal property value declared. There was little or no effort to capitalize earnings, but if the assessor did not agree with the declared value he might call for the filing of balance sheet data. The assessor of the third township assessed mainly according to his knowledge of the company, using a rule-of-thumb standard of about 20 percent of the value of inventories. He considered the tax to be primarily one on profits and kept the assessment low to keep the tax from being "confiscatory" and to keep from provoking moves out of the state. The supervisor of assessments in this county obviously did little supervising.

In the sixth county of this group, the firms under local jurisdiction infrequently filed data needed, so the supervisor of assessments worked out his own method, using the balance sheet data he could occasionally obtain as a benchmark. He subtracted the value of inventories and accounts payable from the value of current assets and then took 10 percent of the result. He did not attempt to set a high figure or assess penalties to induce the

companies to file the requisite information; in fact, he doubted that the companies realized they were being assessed on capital stock because it was included in a total bill for personal property. Neither did he depend entirely on his "formula"; if the resulting figure was out of line with what he knew of the firm, he "adjusted" it. He also "adjusted" the assessed value from year to year according to his knowledge of the firm; and he compared businesses of the same type and size to keep on a par assessed value of what he considered to be similarly situated businesses.

The final county to be discussed is Cook, which is in a class by itself. The method used differed from the department's formula but was about equally complex.

The first operation of the assessor was to compute the capitalized earnings value of the corporation, and it was perhaps here that the Cook County method differed most from the Department of Revenue procedure. Net earnings for the last five years were totaled without weighting; officials felt that the 3-2-1-1-1 system of weighting used and recommended by the department gave too much weight to adventitious circumstances. The assessor therefore computed a straight arithmetical average of the five years' income. From this average of earnings, he deducted an amount equal to 5 percent of net worth to find earnings in excess of 5 percent of net worth. This was done to allow a fair return on net worth before applying the capital stock tax (and to this extent, the capital stock tax in Cook County resembles an excess-profits tax). The assessor then capitalized total earnings in excess of 5 percent of net worth at the rate of 10 percent. The Department of Revenue, of course, makes no allowance for a fair return and uses various rates for capitalization.

The capital stock assessor in Cook County then added net worth (capital surplus, and so on, excluding such items as goodwill and patents) and funded debt. From the resulting net worth figure he deducted (1) tangible property (inventory, machinery, and real estate, for example), no matter where it was located; (2) United States government bonds; and (3) stocks of Illinois corporations, banks, and foreign corporations with tangible property assessed in Illinois. The result of these additions and deductions was the net intangible book value of the corporation. The assessor then averaged this amount with the capitalized excess earnings value to find the total value of capital stock. He took 10 percent of this last amount and entered that figure in the capital stock line of the property tax schedule. (Here again, the Cook County formula differs from that of the Department of Revenue, which assesses capital stock at 55 to 60 percent of full value.)

Other Information from Local Officials

The answers of county officials to questions relating to the assessment of intangibles merely confirmed what was already a virtual certainty. It was generally indicated that intangibles of unincorporated businesses, individuals, and foreign corporations escaped assessment much more often than

not. The reason most commonly stated was that there was no way the assessor could find out who owned what intangibles in what amounts. The most frequent reference was to the fact that assessors could not even discover how much money taxpayers had on deposit in banks.

In a few counties it was asserted that noncorporate intangibles did not wholly escape, but they did escape to a greater extent than corporate intangibles. In still fewer counties those interviewed said foreign corporations were good about declaring some value for such items as cash and credits. More often, however, nothing was declared; or, in some cases, the foreign corporations declared one flat sum for personal property and made no pretense of itemizing values.

In some instances where the basic inequity of such an arrangement was acknowledged, it was excused on the ground that the capital stock tax was not so high in any case that anyone was really hurt. On the other hand, assessors in other localities tried to make up for non-filing of intangible values by assessing tangibles at a "good value."

In many counties those interviewed stated that no attempt was made to assess intangibles; in a few, declared values were accepted; and in two counties declarations of cash and securities were removed so as to put everyone on the same basis. In Cook County it was believed that the assessment procedures there put corporations and partnerships pretty much on a par, but that individuals probably escaped taxation to a greater extent than the other two types of business. In only two counties was there any thought that corporations were assessed less heavily than other forms of business.

Conversations with county officials made it quite evident that in many counties, incompetence and ignorance among township assessors were important reasons for inaction. Another reason was a do-nothing, don't-care attitude among assessors. It was also evident that many county officials were no more competent than township assessors to compute capital stock values. Some of them freely acknowledged their inability and sought help; others took refuge behind "it's never been done."

Even where assessors were regarded as generally competent, it often happened that properties in different townships were assessed differently simply because township assessors' methods were not coordinated, either by the assessors themselves or by any county official. Sometimes the lack of coordination was accidental or the result of inaction; sometimes it was deliberate. Counties in which all the assessors acted in approximately the same manner were rare.

Many county officials suggested the abolition of the township assessor's office and the substitution of a county assessor who would be appointed by the board of supervisors on the basis of merit. However, an optional arrangement such as now exists cannot be considered a solution. It has been a too-common occurrence in recent years that when the supervisor of assessments began to do a reasonably competent job, the voters reversed themselves and abolished the position.

Assessments by Local Officials

The number of locally assessable firms downstate approximately doubled between 1946 and 1960, with some increase each year. In about one-sixth of the counties, the number of firms under the jurisdiction of local assessors in 1960 was well above that in 1946. This group included all of the metropolitan counties. In fully three-fourths of the counties, numbers of locally assessable corporations rose irregularly throughout the postwar period but were not very much higher in 1960 than they had been in 1946. In a half dozen counties, the number of corporations under the jurisdiction of local assessors was unchanged or down.

Despite a fairly steady increase in the number of corporations subject to the tax and the general prosperity of the period, and in sharp contrast to the movement in the total assessments of the Department of Revenue, there has been no very large growth in the total value of local assessments of corporate excess. The total for the state in 1960 was $114.7 million, only 5 percent above the figure for 1946 and well below the levels of the late forties and early fifties. As might be expected, the Cook County total predominated; in 1960, the total Cook County equalized value was $91.1 million, $5 million higher than that of 1946. The downstate total in 1960, at $23.6 million, was about 4 percent higher than the 1946 level of $22.7 million.

In contrast also to assessments by the Department of Revenue, where only a few counties (two in 1960) have failed to receive some assessed valuation on capital stock each year, roughly two-thirds of the counties have not had assessed valuations in one or more of the years since 1946; in 1960, 39 counties had no locally assessed capital stock.

Five counties had no locally assessed capital stock values at all during the 1946-60 period. One-fourth of the counties had no assessments in at least 10 of the 15 years and an additional 21 counties had no assessments in 5 to 9 of the 15 years. It is not surprising to observe that of these 51 counties, only one had an active program of assessment in 1960, and in that case, the program appears to have been started in 1956. The 50 inactive counties were, without exception, rural counties and some of them had only a few firms under local jurisdiction in 1960. However, three of the counties each had over 100 corporations which were judged by the department to be locally assessable. Mere numbers do not, of course, indicate the presence of capital stock values, but it seems most unlikely that there could be very many corporations in a county without there also being assessable capital stock value. Certainly some of the rural counties with a policy of active assessment of capital stock had fewer locally assessable corporations in 1960 than many of these inactive counties, yet they assessed some value of corporate excess.

Even in those years when some value was indicated for locally assessed capital stock in these counties, the aggregate was low. Annual values of more than $100,000 were uncommon; usually the equalized figure reported

was less than $50,000. Inasmuch as these were counties where any value assessed was probably declared voluntarily, this is no more than might be expected.

In 20 counties where assessment took place on the basis of voluntary declaration of value, assessments were indicated for at least 10 of the 15 years. In seven of these counties the total equalized value of locally assessed capital stock was generally less than $50,000. The number of firms per county in 1960 ranged from 15 to 142. The latter county stood out, of course, because although it was fairly industrialized, it had a very low value of assessments for capital stock.

Of this group of 20, six were metropolitan counties, most of which made very poor showings indeed. It was common to find the number of firms generally on the upgrade and the equalized assessed value usually on the downgrade in these counties. In none of these six counties was there any valuation of capital stock by the assessors—any value assessed was voluntarily declared by the corporation. Moreover, in one of these counties declared values were sometimes removed because the tax was considered to be double taxation and unfair.

Of the 32 counties having some sort of assessment program in 1960, seven had not had local assessments in all of the 15 years of the postwar period. With a single exception, however, the seven counties had been assessing capital stock locally at least since 1950. Most of these counties had more locally assessable corporations in 1960 than they had had in the first year they assessed capital stock but in some cases the number had dropped or remained unchanged. In no case was the gain very large. Similarly, the total values of locally assessed capital stock fluctuated, but they generally ended the period at higher levels.

The other 25 counties having active assessment programs had assessed values for corporate excess in all of the 15 years. Among the 24 downstate counties there were increases in numbers of assessable firms in all except one county where there was a small decline. In the metropolitan counties, increases were fairly large, with the numbers doubling or tripling in most cases.

Nearly all of the metropolitan counties included in the group showed substantial fluctuations in total locally assessed values of capital stock over the 15 year period, but total equalized values were generally higher in the latter part of the period than they were in the early years. In most of these cases, any change which had taken place in the county multiplier did not seem to have had much effect on equalized values.

In the rural counties of the group having active assessment programs, increases in numbers of locally assessable firms were coupled more often than not with generally lower equalized values of capital stock. In nine counties values were lower (sometimes much lower), whereas values were clearly

TABLE 5

Number of Corporations Assessable on Capital Stock by the Department of Revenue and by Local Assessors, Number Assessed by the Department and Amount of Assessments, 1960

County	Number Assessable by: Dept. of Revenue	Number Assessable by: Local Assessor	Number Assessed by Dept. of Revenue	Amount Assessed: Dept. of Revenue	Amount Assessed: Local Assessor (Equalized)	Amount Assessed: Total
Entire state	30,478	n.a.	19,638	$538,635,060	$114,742,974	$653,378,034
Downstate	8,593	8,959	6,164	315,509,385	23,598,451	339,107,836
Cook County	21,885	n.a.	13,474	223,125,675	91,144,523	314,270,198
Adams	82	120	55	41,795,800	540,644	42,336,444
Alexander	34	49	26	419,700	1,181	420,881
Bond	16	21	12	66,000	39,556	105,556
Boone	23	48	18	157,500	......	157,500
Brown	8	7	7	33,600	......	33,600
Bureau	38	45	28	441,300	1,154,740	1,596,040
Calhoun	10	6	5	29,900	8,941	38,841
Carroll	12	15	9	425,000	14,077	439,077
Cass	12	17	6	139,600	303,266	442,866
Champaign	252	168	154	2,152,000	427,980	2,579,980
Christian	46	49	36	435,800	1,076,300	1,512,100
Clark	11	12	9	344,900	......	344,900
Clay	13	12	11	95,000	......	95,000
Clinton	20	30	12	87,500	39,124	126,624
Coles	63	78	42	1,361,130	369,340	1,730,470
Crawford	31	27	22	1,369,800	......	1,369,800
Cumberland	1	9	......	......	......	......
DeKalb	93	93	63	1,356,900	142,870	1,499,770
DeWitt	15	16	13	129,050	......	129,050
Douglas	17	20	14	829,650	......	829,650
DuPage	901	382	636	5,136,800	1,247,450	6,384,250

TABLE 5 (Continued)

County	Number Assessable by		Number Assessed by Dept. of Revenue	Amount Assessed		
	Dept. of Revenue	Local Assessor		Dept. of Revenue	Local Assessor (Equalized)	Total
Edgar	17	27	9	$ 91,100	$	$ 91,000
Edwards	10	9	8	147,500	35,855	183,355
Effingham	33	33	23	406,850	......	406,850
Fayette	18	23	14	403,900	......	403,900
Ford	28	36	23	1,401,900	57,510	1,459,410
Franklin	18	41	10	59,900	......	59,900
Fulton	31	73	22	179,900	18,000	197,900
Gallatin	6	5	3	8,900	......	8,900
Greene	13	22	11	68,200	......	68,200
Grundy	21	32	14	172,100	489,269	661,369
Hamilton	5	1	3	7,800	......	7,800
Hancock	41	37	30	408,600	256,375	664,975
Hardin	6	0	6	190,450	......	190,450
Henderson	4	4	3	51,300	......	51,300
Henry	55	64	37	1,429,000	2,439	1,431,439
Iroquois	38	53	25	404,350	29,220	433,570
Jackson	39	56	34	227,500	72,275	299,775
Jasper	3	10	3	3,300	......	3,300
Jefferson	37	106	20	114,700	......	114,700
Jersey	11	21	8	37,500	......	37,500
JoDaviess	21	25	16	123,050	......	123,050
Johnson	0	4	0	......	......	......
Kane	509	566	364	28,923,400	3,088,907	32,012,307
Kankakee	129	142	96	6,031,450	16,500	6,047,950
Kendall	30	25	22	343,700	876,335	1,220,035
Knox	80	134	49	2,093,900	......	2,093,900
Lake	821	500	584	8,843,650	327,690	9,171,340
LaSalle	181	196	128	1,319,850	890,800	2,210,650

TABLE 5 (Continued)

County	Number Assessable by		Number Assessed by Dept. of Revenue	Amount Assessed		
	Dept. of Revenue	Local Assessor		Dept. of Revenue	Local Assessor (Equalized)	Total
Lawrence	26	9	18	$ 532,700	$	$ 532,700
Lee	29	53	22	409,650	34,597	444,247
Livingston	70	61	56	3,471,500	97,504	3,569,004
Logan	39	35	30	343,950	235,598	579,548
McDonough	33	37	20	105,050	1,250	106,300
McHenry	223	141	174	1,484,400	957,800	2,442,200
McLean	116	104	85	2,087,300	1,175,500	3,262,800
Macon	182	228	123	1,069,650	70,573	1,140,223
Macoupin	36	53	32	467,100	......	467,100
Madison	297	388	220	3,241,350	428,420	3,669,770
Marion	63	72	43	631,650	......	631,650
Marshall	10	18	7	46,400	......	46,400
Mason	27	22	23	165,850	186,647	352,497
Massac	11	13	8	9,134,320	37,442	9,171,762
Menard	9	17	7	43,100	106,941	150,041
Mercer	20	18	16	776,800	2,520	779,320
Monroe	30	19	23	511,800	159,180	670,980
Montgomery	39	43	30	209,700	219,650	429,350
Morgan	51	56	37	327,600	488,859	816,459
Moultrie	15	25	11	151,050	......	151,050
Ogle	43	84	30	252,500	125,140	377,640
Peoria	431	658	299	19,649,600	521,040	20,170,640
Perry	17	22	15	125,000	48,170	173,170
Piatt	25	32	16	117,898,200	121,220	118,019,420
Pike	13	22	9	41,900	1,850	43,750
Pope	2	4	1	1,500	......	1,500
Pulaski	5	10	5	89,700	......	89,700

TABLE 5 (Continued)

County	Number Assessable by		Number Assessed by Dept. of Revenue	Amount Assessed		
	Dept. of Revenue	Local Assessor		Dept. of Revenue	Local Assessor (Equalized)	Total
Putnam	6	5	5	$ 100,900	$	$ 100,900
Randolph	42	28	30	187,900	247,868	435,768
Richland	37	16	29	533,450	......	533,450
Rock Island	299	356	203	6,302,210	1,162,947	7,465,157
St. Clair	500	429	379	4,139,500	391,528	4,531,028
Saline	32	26	27	209,600	6,250	215,850
Sangamon	352	381	234	2,501,250	9,912	2,511,162
Schuyler	7	5	5	53,700	17,750	71,450
Scott	3	9	3	56,600	......	56,600
Shelby	15	19	12	51,500	15,055	66,555
Stark	5	8	2	7,700	......	7,700
Stephenson	83	81	61	1,890,800	329,961	2,220,761
Tazewell	106	107	76	2,665,000	......	2,665,000
Union	23	47	18	309,500	394,195	703,695
Vermilion	114	187	88	1,302,150	41,300	1,343,450
Wabash	51	15	40	1,942,450	957	1,943,407
Warren	21	36	16	194,400	......	194,400
Washington	14	17	9	123,800	......	123,800
Wayne	30	21	23	324,800	......	324,800
White	51	16	43	755,175	63,140	818,315
Whiteside	52	104	36	787,600	......	787,600
Will	393	296	312	5,909,750	114,745	6,024,495
Williamson	61	115	40	337,300	20,000	357,300
Winnebago	505	889	349	10,911,100	4,189,565	15,100,665
Woodford	26	33	21	341,250	46,733	387,983

SOURCE: Illinois Department of Revenue.
n.a.—Not available.

higher in only six counties and unchanged in one. Again the changes were usually independent of changes in the multiplier.

Since no information is available on changes in the number of firms locally assessable in Cook County, only the changes in the equalized value can be examined. Equalized values have fluctuated considerably during the 15-year period, ranging from a low of $58,620,662 in 1957 to $93,004,880 in 1959.

In 1960 the group of 32 counties which had active assessment programs accounted for 97 percent of the total of locally assessed capital stock as equalized, $111,380,357 out of $114,742,974 (see Table 5). Cook County alone accounted for 79 percent of the locally assessed total, $91,144,523; thus the other counties with active programs for capital stock assessed approximately 18 percent of the state total valuation. Another 10 counties which had voluntary declarations of capital stock values in all the years 1946-60 had equalized local assessments totaling $2,233,302 in 1960, slightly less than 2 percent of the total for the state. The remaining 60 counties having no programs therefore accounted for only about 1 percent of local assessments of capital stock by value.

The Importance of the Capital Stock Tax

Even though no information could be obtained in the counties as to the amount of revenue yielded by the capital stock tax, an estimate of the 1960 yield can be derived by applying the average tax rate for personal property to the total capital stock assessment for each county—that is, the total of the Department of Revenue assessments plus the total of local assessments as equalized. These computations indicate that two counties received no revenue from the capital stock tax in 1960; 6 received less than $1,000 in revenue; 31 received between $1,000 and $9,999; 26 between $10,000 and $24,999; 13 between $25,000 and $49,999; and 10 between $50,000 and $99,999. Only 14 counties received $100,000 or more in revenue from this source. These 14 counties and their estimated revenues are as follows:

Adams	$ 1,199,539
Cook	14,330,721
DuPage	234,940
Kane	1,066,043
Kankakee	171,157
Lake	371,439
Madison	117,066
Massac	211,868
Peoria	603,102
Piatt	1,073,977
Rock Island	254,562
St. Clair	174,445
Will	172,300
Winnebago	465,100

The total estimated revenue from the capital stock tax in 1960 was $22,176,570.

Probably the best measure of the importance of the capital stock tax in the local property tax structure is presented in Table 6. This table shows the percentages of the total assessed value of property which were accounted for by department assessments, equalized local assessments, and total assessments of capital stock in 1946 and 1960. Plainly, capital stock has not been a major component of the property tax base in very many counties.[8] In total, capital stock assessments were a substantial percentage of total property assessments in 1960 only in Adams, Massac, and Piatt counties. In addition, in the downstate area, Kane and Wabash counties had percentages for capital stock which were noticeably above the average; and Kankakee, Union, and Winnebago counties had percentages which were slightly above average. In no other downstate county did capital stock assessed valuations amount to as much as the average 1.8 percent of total property assessments, and in 14 counties the proportion was less than one-tenth of 1 percent. In Cook County, capital stock assessments accounted for 2 percent of total property assessments.

Local assessments, not unexpectedly, were usually a very small percentage of the total; the highest percentages were 1.1 in Union County and 0.9 in Kendall County. Even for the Department of Revenue assessments, percentages were very low generally, once the counties having large utility assessments were excluded. In every case where the percentage was greater than 1.0, one or more public utilities entered the picture.

The Role of Foreign Incorporation

The capital stock tax law has provided, ever since its passage in 1872, that the tax shall apply only to companies incorporated under the laws of Illinois. All a corporation has to do to avoid the tax is to incorporate in some other state and qualify to do business in Illinois. The annual tax paid by foreign corporations for the privilege of doing business in Illinois is levied at the same rate as the franchise tax paid by domestic corporations; and in addition to the franchise tax, domestic corporations are liable for payment of the capital stock tax. Obviously this amounts to serious discrimination against domestic firms in many cases.

Foreign incorporation does not affect a firm otherwise. The only apparent disadvantage is the trouble of "maintaining an office" in the state of incorporation and paying fees, but some states are notably easy to please in those respects.

One factor which is supposed to redress the balance is the taxation of the intangibles of foreign corporations, provided for by legislation in 1939. In practice, this compensating factor rarely operates, for a variety of reasons.

[8] It should be remembered, however, that even in counties where capital stock assessed values are not a very large percentage of total assessed values, capital stock assessments may be a substantial part of the total property assessment in one or a few tax districts where corporate principal offices are concentrated.

TABLE 6

Percentage of Total Property Assessments Accounted for by Capital Stock, 1946 and 1960

County	D. R./Total 1946	D. R./Total 1960	Local/Total 1946	Local/Total 1960	CS/Total 1946	CS/Total 1960	County	D. R./Total 1946	D. R./Total 1960	Local/Total 1946	Local/Total 1960	CS/Total 1946	CS/Total 1960
Entire state	1.3	1.6	0.5	0.3	1.9	1.9	Edwards		0.6		0.1		0.8
Cook County	1.3	1.4	0.9	0.6	2.2	2.0	Effingham	0.3	0.7	*		0.3	0.7
Downstate	1.4	1.7	0.2	0.1	1.6	1.8	Fayette	0.2	0.4			0.2	0.4
							Ford	*	1.3	*	*	*	1.4
Adams	16.3	15.7	0.3	0.2	16.6	15.9	Franklin	*	*			*	*
Alexander	0.6	1.3		*	0.6	1.3	Fulton	*	0.1	0.3	*	0.3	0.1
Bond	*	0.1		*	*	0.2	Gallatin	*	*			*	*
Boone	*	0.2	*		0.1	0.2	Greene	0.1	0.1			0.1	0.1
Brown		0.2				0.2	Grundy	*	0.1	*	0.4	*	0.6
Bureau	0.1	0.2	0.7	0.6	0.8	0.8	Hamilton	*	*			*	*
Calhoun	*	0.2		*	*	0.3	Hancock	*	0.4	*	0.2	*	0.6
Carroll	1.1	0.5		*	1.1	0.5	Hardin	1.9	0.1			1.9	0.1
Cass	*	0.2		0.5	*	0.8	Henderson	*	0.1			*	0.1
Champaign	0.1	0.5	0.3	*	0.4	0.6	Henry	0.5	0.7		*	0.5	0.7
Christian	0.1	0.2	0.6	0.6	0.7	0.8	Iroquois	*	0.2	*	*	0.1	0.2
Clark	*	0.7			*	0.7	Jackson	0.2	0.2	0.4	*	0.6	0.3
Clay	*	0.2			*	0.2	Jasper	*	*	*		*	*
Clinton	*	0.1		*	*	0.2	Jefferson	0.4	0.1	*		0.4	0.1
Coles	*	0.8		0.2	*	1.1	Jersey	0.1	*			0.1	*
Crawford	0.3	1.7			0.3	1.7	JoDaviess	0.4	0.2			0.4	0.2
Cumberland	*				*		Johnson						
DeKalb	0.1	0.6	0.6	*	0.7	0.6	Kane	0.2	4.0	0.4	0.4	0.6	4.5
DeWitt	0.5	0.1			0.5	0.1	Kankakee	0.2	2.0	*	*	0.2	2.0
Douglas	0.3	0.7			0.3	0.7	Kendall	*	0.4	3.9	0.9	3.9	1.3
DuPage	0.1	0.4	*	0.1	0.2	0.5	Knox	0.3	0.9			0.3	0.9
Edgar	*	*			*	*	Lake	0.3	0.8	*	*	0.3	0.9

TABLE 6 (Continued)

County	D. R./Total 1946	D. R./Total 1960	Local/Total 1946	Local/Total 1960	CS/Total 1946	CS/Total 1960
LaSalle	0.1	0.3	0.1	0.2	0.2	0.5
Lawrence	0.6	0.8	0.6		1.2	0.8
Lee	8.7	0.2	0.1	*	8.9	0.2
Livingston	0.3	1.3	0.2	*	0.5	1.3
Logan	*	0.2		0.1	*	0.3
McDonough	0.1	*		*	0.1	*
McHenry	0.2	0.4	0.2	0.3	0.4	0.7
McLean	0.5	0.5	0.3	0.3	0.8	0.8
Macon	*	0.2	0.6	*	0.7	0.2
Macoupin	*	0.4	*		*	0.4
Madison	0.1	0.4	*	*	0.1	0.5
Marion	0.3	0.5			0.3	0.5
Marshall	*	*			*	*
Mason	*	0.2		0.2	*	0.4
Massac	*	17.4		*	*	17.4
Menard	*	*	0.2	0.2	0.2	0.3
Mercer	0.1	1.1		*	0.1	1.1
Monroe	0.2	1.0	0.3	0.3	0.5	1.3
Montgomery	0.1	0.2	0.4	0.2	0.5	0.4
Morgan	0.2	0.2		0.3	0.2	0.6
Moultrie	*	0.2	0.4		0.5	0.2
Ogle	*	0.1	*	*	*	0.2
Peoria	2.3	0.3	0.1	*	2.4	0.3
Perry	*	0.2		*	*	0.3
Piatt	36.9	50.9	*	*	36.9	51.0
Pike	0.2	*		*	0.2	*
Pope	0.2	*			0.2	*

County	D. R./Total 1946	D. R./Total 1960	Local/Total 1946	Local/Total 1960	CS/Total 1946	CS/Total 1960
Pulaski	0.9	0.7			0.9	0.7
Putnam	*	0.3			*	0.3
Randolph	*	0.3	0.5	0.3	0.6	0.6
Richland	0.5	1.0			0.5	1.0
Rock Island	2.4	1.3	0.1	0.2	2.5	1.5
St. Clair	2.3	0.6	*	*	2.4	0.6
Saline	0.1	0.4		*	0.1	0.4
Sangamon	0.4	0.5	0.1	*	0.5	0.5
Schuyler	*	0.2		*	*	0.2
Scott		0.2				0.2
Shelby	*	*		*	*	*
Stark		*				*
Stephenson	0.5	1.1	1.2	0.2	1.7	1.3
Tazewell	0.1	0.6	*		0.1	0.6
Union	*	0.8		1.1	*	1.9
Vermilion	0.2	0.4	*	*	0.2	0.4
Wabash	0.3	3.9	0.2	*	0.5	3.9
Warren	*	0.2			*	0.2
Washington	*	0.2			*	0.2
Wayne	0.3	0.5			0.3	0.5
White	0.2	1.0	0.1	*	0.3	1.1
Whiteside	*	0.4			*	0.4
Will	4.5	0.9	0.6	*	5.1	0.9
Williamson	0.2	0.4	*	*	0.3	0.4
Winnebago	0.8	1.4	0.9	0.5	1.7	2.0
Woodford	*	0.3	0.2	*	0.2	0.3

SOURCE: Computed from data furnished by Illinois Department of Revenue.
*Less than one-tenth of 1 percent.

The law applies to intangibles having a situs in the state and situs continues to be debated; if the assessor assesses intangibles—that is, if they are not listed by the company (a common occurrence)—he must be able to defend the amount he allocates to each category of intangible property. Intangibles include cash deposited in banks, but the assessor has no means of ascertaining the amounts involved. All this adds up to little effort to assess the intangibles of foreign corporations.

It does not appear that avoidance of the capital stock tax by means of foreign incorporation has increased greatly in recent years, at least so far as numbers are concerned. The proportion of foreign corporations in the total number has apparently remained fairly steady at approximately 14 percent throughout the period since the end of World War II. This says nothing, of course, about the relative importance of those firms which incorporate outside of Illinois, whatever their reasons may be.

Whether a company will incorporate outside the state depends on a number of factors: the type of business, the probable size of the Illinois capital stock tax liability, the amount of the fees and taxes that must be paid in the other state, the relative "bother" (paperwork) involved in meeting requirements for tax assessment in the two states, and several factors unrelated to the amount of capital stock tax liability. These unrelated factors will be discussed presently.

The type of business involved plainly has a great deal to do with whether a company will decide to incorporate out of state. It has been shown that those types of business coming under the jurisdiction of the Department of Revenue are very likely to be assessed on the value of corporate excess, whereas those coming under the jurisdiction of local assessors can easily escape assessment simply by locating their "principal" office in a county which makes no effort to assess capital stock.

The size of the corporation, specifically the size of its corporate excess, and the level of fees and taxes in an alternative state of incorporation are important in that together they set the point at which it becomes advantageous for a corporation to reincorporate outside of Illinois. One of the corporations which makes a business of representing corporations in other states estimates that

> The additional cost of maintaining an average sized Delaware corporation, for example, might be less than $125 or $150 a year, so that any expected annual benefit arising from being a foreign corporation that is in excess of that amount would be profitable. In fact, there is a feeling in some quarters that this low additional cost is justified if only because it avoids studying the problem each year.[9]

With the additional annual cost of foreign incorporation at such a low level, it becomes advantageous for a company to consider such a move as soon as its capital stock assessment reaches $3,000 to $4,000, assuming tax rates of 3 to 4 percent, as is commonly the case. Certainly by the time a

[9] The CT Corporation System in an unpublished leaflet on the "Illinois Capital Stock Tax."

company acquires intangible values of $5,000 it will want to consider out-of-state incorporation unless its "principal office" happens to be located in one of the capital stock tax havens. More than 40 percent of the corporations assessed in 1960 by the Department of Revenue had initial assessments of $5,000 or more.

Aside from the cost of the capital stock tax, there are other factors which may induce a company to incorporate in a state other than Illinois. If a corporation is a subsidiary, the fact that the parent company is incorporated elsewhere may be the deciding factor. Various provisions of the Illinois Business Corporation Act are also important. This law requires that an Illinois corporation may not have nonvoting classes of stock or staggered directors' terms; that shareholders may cumulate their votes if they wish; and that vacancies on the board of directors must be filled by a vote of the shareholders.[10] Clearly, these requirements of the Business Corporation Act will be of serious concern, especially to large corporations.

In order to determine how important the capital stock tax has been as a factor influencing the decision of company officers of Illinois firms to incorporate in a state other than Illinois, inquiries were made in the summer of 1961 of some of the foreign corporations doing business in Illinois to learn the reason or reasons for their having incorporated elsewhere.

It is not possible here to present the findings in detail, but a summary will help to make clear the effect of foreign incorporation on capital stock assessment.

In all but one of the types of business represented in the survey responses, the capital stock tax was the most important single factor which influenced corporation managements to incorporate in a state other than Illinois. In many cases it was much more important than the second-ranking reason. The only group in which it was not the most important reason was manufacturing. Even in wholesale trade and retail trade, where jurisdiction was likely to be in the hands of local assessors, the capital stock tax was the primary reason for foreign incorporation.[11]

When size of assets employed was used to classify the corporations, the capital stock tax was the dominant reason for all except the largest firms—those having assets of $50 million or more—if the provisions of the Business Corporation Act were considered separately. If those provisions were lumped together, then the capital stock tax became secondary with companies having assets of $1 million or more.

A summary of the reasons mentioned and ranked may be helpful. (Not all of those who answered the questions ranked their reasons for foreign

[10] These provisions derive from Section 3 of Article 11 of the Illinois Constitution.

[11] Corporations participating in the study were classified in 16 business groups: manufacturing, wholesale trade, retail trade, manufacturing-retail trade-wholesale trade, manufacturing and/or trade combined with another business, real estate, contract construction, contract construction and/or real estate combined with another business, finance, transportation services, publishing, agriculture, laundry and dry cleaning, amusement and recreation, auto repairs and garage, and other.

	Mentioned; Not Ranked	Rank 1	2	3	4
Subsidiary; parent in other state	2	6	2		
More than half of business done in other state	3	11	4		
Object to provision that:					
Each share shall have one vote	11	14	8		
Each shareholder shall have right to cumulate votes	3	4	2	4	
Directors' terms may not be staggered	3		1	2	2
Vacant board positions must be filled by shareholders' vote	5		5	4	1
Other provisions of Illinois statutes exclusive of Revenue Code	3	2	2		
Illinois capital stock tax	28	81	5	8	2
Other provisions of Revenue Code			3		1
More favorable treatment of corporations in other state	21	9	11	2	
Other	11	36	6	2	

incorporation in order of importance; their reasons are tabulated under "mentioned; not ranked.")

The capital stock tax stands out very clearly as the chief factor which influenced these companies to incorporate in other states. Moreover, many of the responses tabulated under "more favorable treatment of corporations in other state" and "other" included avoidance of the capital stock tax. This was made plain by such comments as "lower taxes . . .," "accountant suggested—supposedly less expensive," "real estate and personal property taxes are ridiculous in Illinois," and "cheaper to incorporate in other state."

More than half of the corporations had saved money, about a fifth had not, and the remainder did not know whether anything had been saved or did not answer the question concerning savings.

Only a fourth of the corporations which stated they had not saved money mentioned the capital stock tax as a factor influencing their incorporation in some other state. Some of these did only a minor portion of their gross business in Illinois; some were building corporations, which often have no capital stock value because real estate and tangible personal property account for the full value; and some were in the smallest asset group, which suggests that their capital stock assessments (if they had been domestic) would have been small, so that foreign incorporation would not effect any great saving.

In the study summarized here, a foreign corporation was classified as a *de facto* Illinois corporation if it had 60 percent of its property and did 60

percent of its business in Illinois. It did not seem unreasonable to count a firm a *de facto* resident of the state in which it owned half again as much property or in which it did half again as much business as it had or did in any other state or in all other states, as the case might be. Under this rule, nearly three-fourths of the firms which took part in the study would be considered *de facto* Illinois corporations.

Shortcomings of the Capital Stock Tax Law

Perhaps the primary flaw in the capital stock tax law is that it applies only to corporations. It is true, of course, that only corporations have capital stock, but it must be remembered that the capital stock tax is intended to apply to the intangible value of corporations and that the tax on the so-called capital stock value is only a device for reaching that value. Unincorporated businesses have intangible values just as corporations do. These intangibles are supposed to be taxed under other provisions of the property tax law, but taxation of intangibles of unincorporated businesses is the exception rather than the rule. In many counties, no attempt is made to assess intangibles, either of unincorporated businesses or of individuals: in a few, voluntary declarations of intangible values are accepted.

There are still some businesses organized as proprietorships or partnerships—in some lines of activity such businesses are, in fact, predominant. When they are in competition with corporations, they clearly have a tax advantage.

The Formula for Computing Full Value

The three factors which the Department of Revenue includes in its formula for calculating the full value of a concern are market value of stocks and bonds, book value of assets, and capitalized earnings value. All three are time-honored measures used by "prudent investors" to value firms in which they may be considering investing. On that basis, the three valuation techniques seem entirely plausible. In assessment work, however, a number of practical difficulties arise. Whereas an investor would both have time and take time to investigate a company or a few companies fully and on the basis of complete information, the Department of Revenue has jurisdiction over 30,000 corporations and must try to "value" them, usually with meager information not subject to a full check. Local assessors have even less information and less adequate means of checking it.

All three methods of finding value entail very large elements of judgment.

In the computation of market value, the assessor must decide whether any changes in prices of stocks and bonds are speculative. This is a question which would give a professional dealer in securities pause; and to arrive at a conclusion a great deal of thought would have to be devoted to the problem. The department assessor (to say nothing of the local assessor) has no time for such analysis and is not, moreover, a securities analyst.

Book value of assets may give less trouble than the other two factors,

but it is not trouble-free by any means. The treatment of depreciation is always a problem. Book value is not the same as actual value in every instance, and when both are given the assessor must decide which is the proper value to use.

The third factor, capitalized earnings, is probably the most difficult of all. The main question is the rate of return which should be used. The department prescribes a basic rate of 7 percent but suggests that rates up to 21 percent may be used, according chiefly to the type of business but according also to the situation of the firm. Rates do not, apparently, vary by 1 or 2 percentage points; the rates generally mentioned are 7, 10, 14, and 21 percent. There is room for differences of opinion on the use of, say, 7 percent or 8 percent for the capitalization of earnings of public utilities; there is much more room for questioning larger percentage differences for businesses of uncertain degrees of risk. In any event, the application of varying rates of capitalization is highly arbitrary and, at the local level, is likely to be capricious. The rate used by the department is varied also according to what the assessor judges to be the competitive position of the firms he is assessing. On this score the judgment of the assessors is likely not to be accurate simply because of their inability to be well informed about all the corporations.

The department evidently recognizes the difficulty inherent in assigning a rate of capitalization, as witness the statement of one assessor that for some types of corporations earnings are ignored and only the book value of assets is considered. This begs the question of worth, however; if earnings value is a factor of worth in one case, it is a factor of worth in other cases also. Moreover, in the case of a service corporation, earnings may be the main factor in worth.

As in the case of market value, there is a judgment to be made in extraordinary cases, as when one year's earnings are exceptional. In such instances, one of three judgments may be made: to increase the rate of return assigned for that year; to ignore the extraordinary year's income and use the previous year's income again; or to change the weight given to the exceptional income. The degree of judgment involved is indicated by the opinion or belief that assessed values should increase but not too sharply. "Not too sharply" is itself a subjective "measure."

In instances of complete lack of current data for a corporation, the department assesses on the value of stated capital plus paid-in surplus as recorded in the Secretary of State's office and then increases the assessment by some amount each year until a protest is registered. This manner of assessing, necessary though it may be, is a matter of almost pure judgment, since stated capital and paid-in surplus often bear little relationship to the real worth of the corporation. In many cases, particularly of older and prosperous businesses, earned surplus and goodwill may account for a substantial portion of full corporation value.

There is in all this not merely the question of how the department assesses any particular firm, but the more important question of how one firm is assessed relative to a competing firm or competing firms. With such a substantial degree of uncertainty, a high degree of inequity is undoubtedly possible and even probable.

Moreover, the initial assessment is not the end of the story. Any corporation "feeling aggrieved" by the department's assessment may, within 10 days of the date of publication of assessments, apply for "a review and correction." The final assessment may depend to a considerable extent on whether the taxpayer protests his assessment and his skill in presenting his case at a hearing.

It is evident that the formula works only very imperfectly even for Department of Revenue assessors, who are skilled in its application in comparison with the unskilled local assessors, who are also supposed to use the formula. It was brought out time and time again by local officials that the mere mechanics of the department's formula were beyond the capabilities of the great majority of local assessors, even if they had the data required. Many assessors have not even had any experience with bookkeeping and are totally lost when it comes to a question of finding the net value of an asset; when capitalization of earnings was mentioned, some of them simply looked blank. One supervisor of assessments who had probably had one of the more adequate examinations given for the position employed a certified public accountant to compute capital stock values.

Exclusion of Foreign Corporations

One of the most serious flaws in the capital stock tax law is its exclusion of foreign corporations. The survey undertaken as a part of this study clearly showed the role the capital stock tax has played in influencing Illinois corporations to seek foreign charters. The tax was important for nearly every type of business except firms engaged almost exclusively in manufacturing. In several cases it was clearly of primary importance—three lines of business in which it was plainly the chief factor were real estate, contract construction, and finance. Even in the predominantly manufacturing group it was important when the products were serviced or repaired, thus putting the firms under Department of Revenue jurisdiction. Furthermore, some companies under local jurisdiction in counties where assessors made an active effort to list capital stock values also had obtained foreign charters.

The tax was the principal influence toward foreign incorporation of firms using assets of less than $1 million. Beyond that point, the provisions of the Business Corporation Act, taken together, superseded the tax in importance.

With regard to savings, it should be clearly understood that the corporations were paying the franchise tax of the other state and the fees entailed in maintaining an office in the other state in addition to paying the

Illinois franchise tax on the allocated part of stated capital plus paid-in surplus.

Some of the savings effected appeared to be very small relative to assets employed. It must be kept in mind, however, that some of these firms were fairly new and expected to save more in the future. The same comment applies to some of those which replied that there had been no saving. Also, among the nonsavers were a few who had incorporated out of state simply to avoid the nuisance of making a return each year to the Department of Revenue.

Of greater concern here is the fact that somewhat more than half of the corporations in the survey did indicate savings and some of them showed very substantial savings. It is evident that these corporations and other corporations which have also saved substantial sums by foreign incorporation are in a superior position relative to competitors who have not obtained foreign charters but are otherwise similarly situated.

In addition to this discrimination in favor of foreign corporations (which are often actually Illinois corporations) and against domestic firms, there is another aspect to the exclusion of foreign corporations which is quite as important to the administration of the capital stock tax. This is the lever which it provides to domestic corporations to avoid or lessen their capital stock assessments. The Department of Revenue is somewhat constrained in its assessments lest it prompt domestic corporations to obtain their charters from other states; and local assessors who actively assess capital stock are also let know that if assessed valuations go too high—that is, higher than the corporations are willing to pay tax on—the corporations will incorporate elsewhere. Local assessors are told, too, that if corporations ever come under department jurisdiction they will seek out-of-state charters. In several counties, local officials took the view that it was best not to antagonize corporations because those already present might incorporate elsewhere or move their plants and because those considering the county as a location might be discouraged from locating there.

The foreign corporation exclusion goes a fair way toward making the capital stock tax no tax at all, but a freewill offering which the corporations are pleased to make from time to time. There are, of course, notable exceptions such as the public utilities; but where there is a possibility of foreign incorporation, assessing officials are subject to some degree of pressure not to assess or to assess at a nominal value.

Compliance

Compliance, or rather lack of compliance, on the part of the corporations subject to the tax is and always has been a difficulty. From the first, corporations have neglected or refused to file the information needed for assessment of capital stock. The statute provides for the imposition of a 50 percent penalty for not filing information, and a number of court

opinions have held that the assessor may assess the value of capital stock on the basis of other information which he may obtain.

Assessing on the basis of other information may work, even if haphazardly, for the Department of Revenue assessors, since they at least are able to obtain information on stated capital and paid-in surplus from the Secretary of State's office; but all too often it is not possible for local assessors to obtain usable information from other sources. This method of assessing is not, therefore, very widely used by local officials.

Failure to file has been followed often enough by no assessment or by a low assessment to make knowledgeable corporate officers consider it worth their while not to comply with the statutory requirement to file the various data.

In some instances, noncompliance takes the form of pleas of double taxation. Despite numerous decisions by the Supreme Court in the 1870's and 1880's, corporations are even now successfully pleading double taxation in some parts of the state to evade local assessment of their capital stock values. The State Chamber of Commerce, which should certainly be familiar with the court opinions and aware of what the capital stock value is supposed to represent, alleged double taxation in its 1959 testimony against the tax.

Divided Jurisdiction and Uniformity

The division of jurisdiction puts about 53 percent of domestic firms under the jurisdiction of the Department of Revenue and leaves 47 percent of the firms in the hands of local assessors. The 53 percent assessable by the department have a better chance of being uniformly assessed than those under local jurisdiction, but even the department assessments leave something to be desired. This is due partly to inadequate information and partly to the number of judgments that have to be made.

The chief source of inequity arising from the divided jurisdiction lies in the fact that those firms which are assessable by the Department of Revenue are fairly certain to be assessed whereas those assessable by local officials may not be assessed. Thus manufacturing or trade corporations which perform service functions, even if only incidentally, will probably be assessed whereas competitors who do not service or repair their products may well escape, depending on the counties in which they have their principal places of business. In addition, department assessments are likely to be higher (perhaps substantially higher) than local assessments on similarly situated corporations. Even in those counties where the Department of Revenue formula is used to compute value, it is common for the actual assessment to be at a much lower proportion of full value than the department's 55 to 60 percent. In counties where the department's formula is not used—where the assessors have set up their own methods—assessments of capital stock are often at nominal values.

There is a very substantial degree of inequity and lack of uniformity in assessment as between counties. Cook County and several of the metropolitan counties do assess capital stock values—in fact make a vigorous effort to assess—but some of the metropolitan counties (Peoria, Sangamon, Macon, Rock Island, Tazewell, and Will) and some of the fairly industrialized counties (such as Kankakee and Vermilion) do not make any effort, but usually passively accept whatever valuation the corporations see fit to declare on their returns. Thus firms having their principal places of business in the second group of counties have an advantage relative to any competitors located in the first group.

There is also inequity among the counties which do assess. Assessors use the department's formula at least as a starting point in many of the counties wherein an active effort is made to assess capital stock, but it is often no more than that. The assessors generally use a great deal of judgment with regard to rate of return for capitalization, which judgment does not always coincide with what the department or their neighbors are doing; sometimes they work through the department's formula and then "adjust" or "temper" the result according to what they know of the firm; or they may "adjust" the result to keep it in line with the assessments of other similar businesses, which usually means a cut in the value to some nominal level.

In other counties, assessors simply use methods of their own devising, and in all of these methods a large element of judgment is inherent. In some cases assessment is based on nothing more than what the assessor thinks the corporations can or should pay. In most such cases, valuations are low. It frequently happens that this "method" is used when corporations are uncooperative about filing information.

There is no uniformity, either, in the proportion of "full value" which is assessed in the different counties. Proportions of full value found in the survey of counties ranged from 10 percent to 65 percent. In some counties intangibles are assessed at a higher proportion than tangibles "because they are easier to conceal"; in other counties they are assessed at a lower proportion than tangibles in order to induce the declaration of intangible values or in order not to penalize corporations relative to unincorporated businesses. The greatest difference between capital stock proportion and the proportion of full value for other types of property found in the survey of counties was 10 percent for capital stock and 40 to 60 percent for other types of property.

An example of this is found in the differences among Cook, DuPage, and Kane counties. Cook County values capital stock according to its own extralegal if not illegal method and assess at 10 percent of "full" value. DuPage County uses the department formula and assesses at 55 percent. Kane County also uses the department formula, using a straight 7 percent rate for capitalization, but assesses at 10 percent. The difference is especially

noticeable with regard to the city of Elgin, which lies partly in Cook County and partly in Kane County.

There is inequality also within counties. This was made clear by the situation in the county where three township assessors were making all the assessments made in the county, and each of the three was using a different method.

A large part of the difficulty at the local level is due to the number of people making capital stock assessments. With a horde of people authorized to make such assessments, it is not surprising that such diverse methods and results are found. Many local assessors are not competent to assess capital stock values. Even in those instances where an assessor is competent, he may disregard the department's formula (which, however imperfect it may be, would foster uniformity if it were more widely used) and arrive at capital stock values by whatever method he chooses to use.

The establishment of an office of supervisor of assessments in some counties it not a guaranteed remedy. Few individuals have the necessary skill and experience to assess capital stock and other complex forms of property. Some supervisors of assessments are scarcely more competent than those they are supposed to supervise, some are no more than political "hacks," and those who are competent and do good work are likely to find themselves out of a job.

Assessment at Principal Place of Business

A corporation is not merely allowed to choose almost any place it pleases for its principal place of business; it is virtually invited to seek a low-rate tax district and to manipulate its tax assessments so as to put the maximum value into the low-rate district. This provision of the law does not, of course, affect corporations having all their property in one location, but it does affect those which operate in more than one taxing district and it particularly affects public utilities. The capital stock assessment is a residual—total value minus assessed values of real estate and tangible personal property—and any value which can be cut off realty and tangible personalty assessments in high-rate districts and added to that in a low-rate district is to the advantage of the corporation. It is to be remembered in this connection that local officials do not usually actually assess the real estate and tangible personal properties of utilities. Rather they accept values declared by the corporations.

The manipulation of assessed valuations in this fashion greatly increases the inequity of an arrangement which would be inequitable in any case. The assessment of capital stock in one location ignores the fact that the revenue of a corporation is drawn from the entire area in which the corporation operates (including out-of-state areas, if the corporation operates across state lines) and the fact that other locations presumably furnish some service relative to intangible value as they do in relation to tangible property. That is to say, the taxing district of the principal place of business receives

tax revenue for service not rendered and other tax districts do not receive revenues for services which they do render. This inequitable distribution of revenues has brought some wholly unwarranted windfalls to a certain few fortunate tax districts.

Yield and Revenue Windfalls of the Tax

One favorable thing can be said about the tax, even though it is in the nature of faint praise. Despite the imperfections of the capital stock tax law and despite the fact that in most counties capital stock values do not account for a large proportion of assessments, the total yield of the tax can hardly be called insignificant. The estimated revenue from the tax in 1960 exceeded $22 million, with about two-thirds of that amount going to taxing districts in Cook County. Capital stock also accounted for substantial proportions of total assessed valuations and produced sizable amounts of revenue in a few other counties. Total revenues from capital stock were over $1 million in each of three counties besides Cook—Adams, Kane, and Piatt; taxing districts in Quincy, Aurora, and Monticello received most of the revenue in those counties. Taxing districts in a few other counties, mostly metropolitan counties, also received fairly large amounts of revenue from the capital stock tax. These districts are the beneficiaries of the principal place of business provision and would certainly oppose any change in that provision or the repeal of the capital stock tax law.

A Solution for the Problem

The foregoing analysis has made it clear that if the capital stock tax is to fulfill the duty for which it was originally intended—the taxation of corporate intangible value—it cannot be left in the hands of local officials who are generally not capable of assessing such values, or who are too easily persuaded that such values should not be assessed, or who simply do not care. Moreover, no significant degree of uniformity is to be achieved if the tax is left in the hands of about 1,500 assessors. To ensure fairly certain assessment and something approaching uniformity, administration of the tax would have to be returned to the exclusive jurisdiction of the Department of Revenue.

This cannot really be considered a complete solution, however. Corporations do not always comply with the requirement to file information, even when they are dealing with the department, and the department often has a great deal of difficulty in obtaining information. Department of Revenue assessment would not be effective, either, unless the foreign incorporation loophole were closed; and to attempt such a closure would raise other problems. There is a strong sentiment against one state's taxing the corporate excess of corporations created by other states and it is by no means certain that such attempted taxation would be upheld in the courts. Moreover, not all of the foreign corporations doing business in Illinois are *de facto* Illinois firms; many of them are bona fide foreign corporations which have only a small fraction of their property and business here.

In view of the serious difficulties involved in trying to make the capital stock tax workable, it would be more sensible to substitute a corporate income tax which could be applied to all corporations (foreign as well as domestic) on the same basis—the amount of income derived from transactions in Illinois. A similar personal income tax would remove the present discrimination against corporations and in favor of unincorporated businesses. It is not suggested that a corporate income tax would present no problems; but other states have worked out practicable procedures and Illinois can surely do as well.

A corporate income tax would have several advantages over the present capital stock tax. Tying the state corporation income tax to the federal tax would relieve corporations of having to make two returns and would be advantageous to state officials because they could thereby have the benefit of the auditing procedures of the federal taxing officials. Enforcement would also be facilitated. Income is more easily valued than worth and, once defined, is less susceptible to subjective valuations. An income tax is closely related to ability to pay; one of the complaints about the capital stock tax has been that it often bears little or no relationship to ability to pay.

Income is usually apportioned to the various states in which a corporation operates on the basis of such factors as tangible property, compensation of employees, and gross receipts within the state as a proportion of the totals of these values (the so-called Massachusetts formula). The technique requires state administration, but there is no reason why part of the revenue from a corporation income tax could not be distributed to the local school districts to replace the revenue lost by the repeal of the capital stock tax. An appropriate basis for distributing revenue would be the number of pupils enrolled in primary and secondary schools, since schools now receive 60 percent or more of tax revenues in most counties. On that base, Cook County would have received 44 percent of the state total in 1960 instead of the 65 percent of capital stock tax revenue received. A few other counties would also suffer a decline in revenues because they would no longer be favored by the principal place of business provision. The fact that a few tax districts would lose the advantage of a grossly inequitable tax boon is, however, hardly an admissible argument for perpetuating it. It is interesting to observe the possible changes for a few other counties also (percentage share of total 1960 capital stock revenue is given first, then the percentage of total 1960 primary and secondary school enrollment): Adams, 5.4 and 0.7; Champaign, 0.4 and 1.3; DuPage, 1.0 and 3.6; Kane, 4.8 and 2.3; Lake, 2.0 and 3.4; Madison, 0.5 and 2.7; Massac, 1.0 and 0.2; Peoria, 2.7 and 1.9; Piatt, 4.8 and 0.2; Rock Island, 1.1 and 1.7; St. Clair, 0.8 and 2.7; and Winnebago, 2.1 and 2.5. Most counties would, naturally, gain by such a distribution. In order to avoid net tax revenue increases to school districts, the law could require that the amount received by a school dis-

trict from its share of corporation income tax collections be offset against the property tax levy of the school district.

To get some idea of how much revenue there would be to distribute, it is necessary to select for a comparison some state which is similar to Illinois and which has an income tax. The state chosen here is California, which levies on all corporations doing business in the state a 5.5 percent franchise tax measured by net income derived from or attributable to sources within the state. In 1960 this tax yielded $236.5 million. If it is assumed that Illinois corporate income would bear approximately the same relationship to California corporate income as Illinois personal income bears to California personal income, a similar tax levied in Illinois would have yielded about $144 million, or somewhat more than $26 million for each 1 percent of rate. Thus Illinois could levy a 1 percent net income tax and derive more revenue from it in total than is now derived from the capital stock tax as it is presently administered. Collections from any rate levied in excess of 1 percent could be used to provide urgently needed additional revenue for state purposes.

One final comment should be made with regard to a corporate income tax. If Illinois levied such a tax, something less than the whole of its state tax liability would be added to the tax bill of each corporation. There is a provision in the federal income tax law which permits a deduction of state income taxes in computing the tax base for the federal tax so that actually only about half of a state corporation income tax would be a net addition to a firm's total tax bill in the case of most of the larger companies.

If it is not feasible to substitute a state corporation income tax for the capital stock tax or to adopt the less desirable plan of retaining the tax and giving the Department of Revenue exclusive jurisdiction over capital stock assessments, then a third alternative is recommended in the interest of equity between corporations. It is recommended that the capital stock tax be repealed and the shares of domestic corporations be made assessable in the hands of Illinois owners. Under this plan, the assessment of shares of domestic corporations would probably go largely by default as is true in the case of other intangibles under past and current practices in Illinois. It would thus roughly equalize the tax treatment of intangibles. Obviously, this plan should not be adopted except as a matter of last resort.

CHAPTER XIX

TAXATION OF FINANCIAL INSTITUTIONS

By H. K. Allen

Building and loan associations, credit unions and banks are not subject to the Illinois capital stock tax which is discussed in the chapter on General Corporation Taxes. It is desirable, therefore, to evaluate the methods of taxing these financial institutions. These companies, like corporations in general, are taxed on their real estate at the same rate that applies to other realty in the same taxing district. It is in the taxation of intangibles that differences arise.

Building and Loan Associations and Credit Unions

Shares of stock in building and loan associations are assessable under Illinois law in the hands of shareholders in the place where the shareholder resides. The shares are assessed under the general property tax in the same manner as other personal property. In the case of out-of-state shareholders, the shares of stock are assessed at the place where the association is located. In computing the value of the shares, the statute permits the deduction of the value of real estate owned by the association. Provisions for assessing the shares of credit unions are similar to those applicable to shares in building and loan associations.

According to statistics compiled by the Federal Home Loan Bank Board, the amount of savings capital of federal and state-chartered savings and loan (buildings and loan) associations in Illinois on December 31, 1961 was $6,464,075,000.[1] In the 1962 edition of the Credit Union Yearbook, it is estimated that the value of savings and deposits of credit unions in Illinois on December 31, 1961 was $403,508,631.[2] Statistics are not available as to the actual assessments of shares in building and loan associations and credit unions in Illinois, but the assessment of such property is infinitesimal. The total equalized assessed valuation of all stocks and bonds (exclusive of bank shares) in the hands of individuals in 1960 was only $112,986,678. In the opinion of the writer, shares in building and loan associations and credit unions escape assessment to an even greater extent than is the case with other intangibles, except bank shares.

Whatever plan is adopted for the taxation of other intangibles—low rate property tax, special tax on individual net income, or general individual income tax—should be extended to shares in building and loan companies and credit unions.

Commercial Banks

The taxation of banks by state and local governments has been markedly affected by federal laws and court decisions. National banks are

[1] *Combined Financial Statements,* 1961, p. 32.
[2] Page 12.

organized under federal statutes and can therefore be taxed only in the manner authorized by such statutes. In addition to taxing the real estate of a national bank in the same manner that other real estate is taxed, a state may choose one of the four following methods:

1. A tax on bank shares but at a rate not higher than that applicable to "other moneyed capital" in the hands of individual citizens.
2. A tax on net income of the bank with the rate not to exceed that on other specific classes of corporations.
3. A tax on net income from dividends to the stockholder, limited also by the "other moneyed capital" clause.
4. A franchise tax measured by net income, also subject to the limitation that the rate cannot exceed that on other specified classes of corporations.

A state may not impose both a share tax and an income tax on banks, but a tax may be imposed on the dividend from bank shares to the stockholder in conjunction with either a tax on net income or a franchise tax measured by net income. The purpose of the franchise tax alternative was to permit states to reach income from tax exempt sources. No authority is granted under federal permissive legislation for taxation of the tangible personalty of national banks. Nor do federal statutes permit a direct levy against national banks on capital stock. Most states tax state banks in accordance with the method adopted for the taxation of national banks. They cannot legally discriminate against national banks, and if they attempted to discriminate against state banks the latter would be encouraged to surrender their state charters for national charters.

In Illinois, no attempt has been made to impose any tax other than the general property tax upon real estate, tangible personal property of state banks, and bank shares. Notwithstanding that tangible personal property of national banks is exempt, the Attorney General of Illinois has ruled that such property of state banks is taxable.[3] Federal statutes do not permit the taxation in Illinois of shares owned or held in Illinois of capital stock of national banks located in other states.

The real estate of banks and the tangible personalty of state banks is assessed by local assessors, and taxed at the same rate as other property in the locality. The shares of State and national banks are also assessed by local assessors and are subject to taxation at the uniform rates of the general property tax. All state and national bank shares are assessed and taxed at the place where the bank is located, regardless of where the stockholders themselves reside. The assessment is made in the names of the individual shareholders, although the tax is collected from the banks; the banks do not recover the tax from their stockholders. While the bank share tax is nominally against the shareholder, it is against the bank in reality. The ultimate burden of the tax is, of course, borne by the stockholders because it reduces

[3] Attorney General, *Report and Opinions*, 1936, p. 224.

the amount of earnings that would otherwise be available for dividends.

The items included in the assessment of bank shares are capital, surplus, undivided profits, and reserves, other than normal-operating reserves for taxes, interest, and current expenses. In computing the assessment, deductions may be made from "total capital funds" for the equalized assessed valuation of real estate, or any actual depreciation of assets, and for other specific items that are proper offsets against capital funds.

The total equalized assessed valuation of shares of bank stock in 1960 amounted to $187,536,130, or 2.8 percent of total personalty assessments. Of the over-all sum, Cook County assessments represent about one-half and downstate counties the other half. Total assessments of bank stock are much more than that of all other taxable stocks and bonds, the amount for the latter in 1960 being 112,986,678. It is estimated that the yield from 1960 property tax levies on bank shares will amount to about $6,900,000.

Statistics are not available as to the actual value of shares of stock in Illinois banks, but it is certain that gross discrimination against such shares arises from the prevailing methods of taxing bank stocks and other intangibles. In the first place, the assessment schedule for bank shares is filed by the bank, and the assessment is therefore much more complete than it is in the case of other taxable intangibles. Because published statements of banks are freely available to assessors and because banks fill out the assessment schedules, shares of bank stock, moreover, are generally assessed at a higher percentage of actual value than are other intangibles.

As previously mentioned, shares of stock in domestic corporations, other than banks, are exempt from the property tax on the ground that the issuing corporation is subject to a capital stock tax. But as a matter of fact, many corporations are not assessed for capital stock tax purposes and, of those that are assessed, many of the assessments are only of a nominal character. It was also mentioned earlier that shares of a foreign corporation are exempt in Illinois provided the corporation pays any property tax whatever in the state. Vast quantities of stocks are thus legally exempt from taxation. Owners of shares of stock in Illinois banks, however, enjoy no such tax exemption privileges.

Not only do serious inequities exist from the differences in the assessment of bank shares and other intangibles, but procedures for assessing bank shares vary among banks located in different counties as well as among those within the same county.

The method of assessing taxable reserves such as reserves for dividends payable, contingency reserves, and special reserves for depreciation of assets varies widely from one county to another. In some counties such reserves are listed at book value, whereas in others they are omitted entirely. The practice of deducting large sums from capital funds for "depreciated assets" is widespread. Usually the same depreciation factor is applied uniformly to the capital funds of all the banks in a county, but in some counties not all

banks are treated alike. The application of varying depreciation factors results in discriminatory taxation. A deduction is permissible to the extent that assets are actually depreciated, but the amounts deducted in many counties appear to be excessive. Because of the large volume of government securities owned by banks and the otherwise strong position of banks, it is not logical that large deductions for depreciated assets can be justified. The practice of making excessive deductions for depreciated assets no doubt arises from efforts to reduce the burden of taxes on bank shares to a level more nearly in line with that on other intangibles. Excessive deductions, nevertheless, do not have legal sanction, and, moreover, the wide variations in the percentages used result in unequal tax burdens among banks.

Another defect is that the tangible personal property of state banks is subject to taxation while under federal laws such property of national banks cannot be taxed. This discrimination could be avoided if banks were permitted to deduct the assessed valuation of tangible personalty in computing the net assessed valuation of the shares. Such a deduction is permitted in computing the corporate excess of corporations subject to the capital stock tax. The current treatment of tangible personal property results in discrimination against state bank shares.

Also open to objection is the current practice relative to the amounts deducted for real estate owned by the bank in computing the assessed valuation of the shares. The equalized assessed value of the real estate owned by the bank and situated in the county where the bank is located may be deducted in computing the value of the shares. The amount of the deduction, however, cannot be greater than the amount at which the real estate is carried on the balance sheet. In recent years many banks have reduced the figure at which they carry the banking house (real estate) on their books to $1 or some other nominal amount. Yet banks in many counties are permitted to deduct the equalized assessed value of real estate notwithstanding the fact that it is carried on the books at a nominal figure. In some counties, however, the deduction for real estate is made in strict compliance with the law. This lack of uniformity in determining deductions for real estate further contributes to inequalities in tax burdens among the banks.

A final objection to the present method of taxing bank shares is that book values only are considered in computing the assessment. Yield or market values are not taken into account. It is true that market values are readily available for only the largest banks, but market values are influenced significantly by net earnings. The relationship between the bank share tax and net earnings varies widely among the banks. A study of this relationship in sixty-three Illinois banks made several years ago by the Revenue Laws Commission found that the percentages of the bank share tax to net earnings varied from zero to 47.5 percent, with an average of 9.2 for the group.[4] The burden of the bank share tax relative to the earnings from which the

[4] *Report of the Revenue Laws Commission,* State of Illinois, 1949, p. 227.

tax is paid varies widely among different banks. The burden of this tax in general is substantially greater than that on other intangibles.

In considering a solution for the problem of taxing bank shares in Illinois it may be helpful to refer to the methods used by other states.[5] Approximately one-fifth of the states tax bank shares under the general property tax. Slightly less than one-third of the states levy special low property tax rates on this class of personalty, and the remainder use either the net income or the franchise tax based on net income method of taxation. A majority of the states that levy either a net income tax or a franchise tax measured by net income on banks, levy an additional tax against stockholders based on dividends received from bank shares. It will be remembered that this practice is permitted under existing federal statutes.

In compliance with the requirement of the federal law that property taxes on national bank shares cannot be higher than the rates on "other moneyed capital" the special rates levied by the states on both national and state bank shares are usually the same as those levied on other intangibles. Similarly, the rates levied on net income from dividends to stockholders of banks are never higher and usually the same as those applicable to income from other financial corporations.

Whatever plan may be adopted for the taxation of bank shares, the existing discrimination between bank shares and other intangibles should be corrected. Despite the fact that federal laws are designed to protect national banks against discrimination, the method employed in Illinois actually discriminates against shares of both national and state banks as compared with other intangibles.

Because of the complexities involved in the assessment of bank shares, it is doubtful whether most local assessors can perform this task in a satisfactory manner. If local assessment is to be continued, better qualified assessors will be needed in most counties.

Assuming adoption of the special or classified property tax approach, consideration should be given to transferring the jurisdiction of bank share assessments to an appropriate state agency. A properly staffed and equipped state agency should be able to assess this class of personalty in an accurate and uniform manner. It will be remembered that bank shares in Ohio are assessed by a state agency. If this plan should be adopted in Illinois the assessments should be allocated back to the local taxing districts in which the bank is located.

Instead of levying a special property tax on bank shares, an alternative plan would be to levy a state income tax on banks or an income tax on stockholders on dividends from bank shares, or both. Almost one-half of the states levy either a net income tax on banks or a franchise tax based on net income; and a majority of the states that levy an income tax on banks also

---

[5] *Tax Systems*, Twelfth Edition, Commerce Clearing House, Inc., and *Property Tax Assessments in the United States*, U.S. Bureau of the census, 1957.

include dividends from bank shares in taxable income under state individual income taxes. In 1949, the Revenue Laws Commission recommended adoption of a corporation privilege tax measured by net income in lieu of the property tax on bank shares.[6] If the income tax approach should be used, it can only be in conjunction with a general state corporation income tax levied with a rate at least as high as that applicable to bank income. Federal statutes also require, as previously noted, that an income tax on stockholders on dividends from bank shares cannot be at a higher rate than that applicable to income from "other moneyed capital."

The advantage of the income tax over the bank share tax is that income is a more reliable criterion of capacity to pay taxes than is the assessed value of bank shares. The disadvantage is that revenues from an income tax would go into the State Treasury, and some local taxing districts would be adversely affected by the loss of property tax revenues from bank shares. The Revenue Laws Commission proposed a partial solution to this problem in 1949 by recommending that revenues from a proposed state tax on the net income of banks be returned to local school districts on a basis of pupils in average daily attendance and that the amount so returned be deducted by the county clerk from the extendible property tax levy for educational purposes. Depending upon amounts now collected by school districts from bank share taxes, the yield of an alternative state income tax, and the number of pupils in average daily attendance, some shifts in revenues among school districts would result from the proposed tax offset arrangement. Other taxing districts in which banks are located would incur some loss of revenues from substitution of an income tax for a bank share tax, but in most cases the amount of such revenue loss would be small.

[6] *Report of the Revenue Laws Commission, op. cit.,* **Summary of Recommendations, p. 16.**

CHAPTER XX

SALES AND USE TAXES

By A. James Heins*

The retail sales tax is one of many American institutions which originated as temporary measures but which subsequently became permanent and of vast importance on the American scene. Although West Virginia enacted a form of the sales tax in 1921 and Georgia followed in 1929, the fundamental sales tax movement awaited the Great Depression of the 1930's. Many states facing precipitous declines in property tax revenues from loss of property values and from increased delinquencies adopted taxes on retail sales. For the most part these taxes were intended to be temporary, but of the thirty-three states that adopted the sales tax during the 1930's, only four no longer have such a tax.

The sales tax has continued to spread and today thirty-seven of the fifty states impose some form of tax on retail sales. Table 1 shows the years in which the various states adopted the sales tax and the present and original rates of taxation. Not only has the tax spread among the states, but tax rates have generally increased. Of the thirty-seven states, twenty-two have tax rates higher than the original rate; fifteen currently have the rate originally imposed; and in no case does a state have a sales tax rate lower than the original rate.

TABLE 1

General Retail Sales Tax by State: Year Effective and Rate of Tax

State	Year Effective	Retail Rate (Percent)	
		Original	1962
Alabama	1937	1.5	3.0
Arizona	1933	2.0	3.0
Arkansas	1935	2.0	3.0
California	1933	2.5	3.0
Colorado	1935	2.0	2.0
Connecticut	1947	3.0	3.5
Florida	1949*	3.0	3.0
Georgia	1951*	3.0	3.0
Hawaii	1935	1.25	3.5
Idaho	1935	2.0	†
Illinois	1933	2.0	3.5
Indiana	1933‡	0.25	0.375

*The author is Assistant Professor of Finance at the University of Illinois.

TABLE 1 (Continued)

State	Year Effective	Retail Rate (Percent)	
		Original	1962
Iowa	1934	2.0	2.0
Kansas	1937	2.0	2.5
Kentucky	1960*	3.0	3.0
Louisiana	1942*	2.0	2.0
Maine	1951	2.0	3.0
Maryland	1947*	2.0	3.0
Michigan	1933	3.0	4.0
Mississippi	1930	0.25	3.0
Missouri	1934	0.5	2.0
Nevada	1955	2.0	2.0
New Jersey	1935	2.0	†
New Mexico	1935	2.0	2.0
New York	1933	2.0	†
North Carolina	1933	3.0	3.0
North Dakota	1935	2.0	2.0
Ohio	1935	3.0	3.0
Oklahoma	1933	1.0	2.0
Pennsylvania	1953*	3.0	4.0
Rhode Island	1947	1.0	3.0
South Carolina	1951	3.0	3.0
South Dakota	1933	1.0	2.0
Tennessee	1947	2.0	3.0
Texas	1961	2.0	2.0
Utah	1933	0.75	2.5
Vermont	1933	2.0	†
Washington	1933	2.0	4.0
West Virginia	1921	2.0	2.0
Wisconsin	1962	3.0	3.0
Wyoming	1935	2.0	2.0

SOURCE: Tax Foundation, Inc., *Retail Sales and Individual Income Taxes in State Tax Structures*, Project Note No. 48 (New York, 1961), Table 7. Wisconsin data are from current newspaper accounts.

*Year present tax became effective. Previous tax levied as follows: Florida 1935-1941; Georgia 1929-1931; Kentucky 1934-1936; Louisiana 1931-1940; Maryland 1935-1936; Pennsylvania 1932-1933.

†Does not currently impose tax which was repealed or allowed to expire as follows: Idaho 1936; New Jersey 1935; New York 1934; Vermont 1935.

‡Gross income tax.

Since 1930 the sales tax has become the most important source of state tax revenue, rivaled only by the individual and corporate income tax and the motor fuel tax. In 1961 the sales tax provided states with 23.7% of their tax revenue although not imposed in fifteen states during that year. Texas and Wisconsin adopted the sales tax after the close of the 1961 fiscal year bringing the total to thirty-seven states currently imposing the sales tax.

This compares with the 19.0% provided by income taxes and the 18.0% provided by the motor fuel tax used in all fifty states. In the meantime the property tax declined from its number one status as a state revenue producer—27.2% of all state tax revenue in 1931—to that of an also-ran providing only 3.3% of state tax revenue in 1961. Table 2 shows the relative and absolute growth of state sales tax revenue and individual and corporate income tax revenue since 1931. While it declined slightly in relative importance during World War II, the sales tax has otherwise grown in importance during every period since 1931.

Table 3 shows the amount of revenue produced by the major taxes in the fifty states during the fiscal year 1961 and the percent of total state tax revenue produced by each tax. Of the thirty-five states imposing a sales tax in 1961, that tax was the major producer in thirty states. Only in five sales tax states was some other tax more important; the income tax in Colorado and Maryland; the severance tax in Louisiana; the motor fuel tax in Oklahoma; and both the income and motor fuel taxes in North Carolina. Of the twenty-six states imposing both a sales tax and an income tax, twenty-three relied more heavily on the sales tax. Two states, Hawaii and Washington, derive over 50% of their tax revenue from the sales tax, while in five others —Arizona, Illinois, Indiana,[1] Michigan, and West Virginia—the sales tax provides over 40% of the total. Of the remaining states, thirteen rely on the sales tax for more than 30% of their tax revenue, thirteen for more than 20%, and only two for less than 20%. The sales tax has become very important indeed.

Growth of the Sales Tax in Illinois

In 1961 only a few states relied more heavily on the sales tax than Illinois—Washington, Hawaii, West Virginia, and Indiana—and because of recent changes in the Illinois tax, it is likely only Washington and Hawaii will have been more dependent in 1962. Table 3 indicates that Illinois derived 43.9% of its revenue from the sales tax in 1961 compared with the 16.7% contributed by its closest competitor, the motor fuel tax.

Illinois adopted a sales tax in 1933 at a rate of 2.0% after a graduated income tax was found objectionable to the state constitution. As in many other states, the tax was a temporary depression measure to relieve pressing revenue problems due to decreased tax collections and a huge increase in the relief rolls. The General Assembly made the tax permanent in 1935, however, and raised the rate to 3.0%.

The sales tax rate was lowered to 2.0% in 1941 and that rate was ample to finance the relatively low state expenditures during the war and immediate post-war period and even to accumulate a substantial surplus in the state general fund. As mounting expenses took their toll after 1950, however, the Illinois legislature was forced to raise the rate in steps of one-half of one percent in 1955, 1959, and 1961 to the present level of 3.5%.

[1] Indiana imposes a gross income tax.

TABLE 2

Growth of State Taxes in the United States

(Dollar Amounts in Millions)

Year	Total State Taxes	General Sales Taxes	Sales Taxes As a Percent of Total	Individual and Corporate Income Taxes	Income Taxes As a Percent of Total	Other State Taxes	Other Taxes As a Percent of Total
1931	$ 1,778	$ 4	.2%	$ 51	2.9%	$ 1,723	96.9%
1937	2,759	431	15.6	245	8.9	2,083	75.5
1941	3,606	575	15.9	422	11.7	2,609	72.4
1946	6,014	900	15.0	831	13.8	4,283	71.2
1950	7.912	1,670	21.1	1,310	16.6	4,932	62.3
1955	11,597	2,636	22.7	1,831	15.8	7.130	61.5
1958	14,919	3,507	23.5	2,562	17.2	8,850	59.3
1961	19,057	4,510	23.7	3,621	19.0	10,926	57.3

SOURCE: Bureau of the Census, *Compendium of State Government Finances* (1931-1961).

TABLE 3

Revenue (Percent of Total Revenue) Collected by the States From Various Sources in Fiscal Year 1961
(In Millions of Dollars)

State	General Sales Taxes	Personal and Corporate Income Taxes	Motor Fuel Taxes	Tobacco and Alcohol Taxes	Other Taxes	Total State Taxes
Alabama	$ 91.5(32.7)	$ 35.2(12.6)	$ 72.9(26.1)	$ 26.1(9.3)	$ 53.8(19.2)	$ 279.5
Alaska		11.8(37.3)	5.1(16.1)	3.8(12.0)	10.9(34.5)	31.6
Arizona	70.8(40.4)	20.9(11.9)	26.4(15.1)	7.5(4.3)	49.7(28.4)	175.3
Arkansas	55.5(33.6)	21.3(12.9)	39.7(24.0)	15.2(9.2)	33.6(20.3)	165.3
California	714.9(31.9)	543.0(24.2)	349.6(15.6)	116.5(5.2)	519.6(23.2)	2,243.6
Colorado	52.2(23.7)	70.6(32.1)	38.2(17.4)	6.2(2.8)	52.6(23.9)	219.8
Connecticut	79.6(31.7)	30.8(12.3)*	46.8(18.6)	19.3(7.7)	74.7(29.7)	251.2
Delaware		34.2(44.4)	8.8(11.4)	3.9(5.1)	30.1(39.1)	77.0
Florida	170.2(32.2)		126.5(23.9)	57.0(10.8)	174.8(33.1)	528.5
Georgia	140.1(35.6)	77.0(19.6)	86.1(21.9)	41.6(10.6)	48.4(12.3)	393.2
Hawaii	68.0(51.4)	38.0(28.7)	11.2(8.5)	5.8(4.4)	9.2(7.0)	132.2
Idaho		24.4(35.0)	14.7(21.1)	5.1(7.3)	25.6(36.7)	69.8
Illinois	384.0(43.9)		146.3(16.7)	83.7(9.6)	260.3(29.8)	874.3
Indiana	192.1(47.9)		101.8(25.4)	31.3(7.8)	76.2(19.0)	401.4
Iowa	83.2(31.0)	42.0(15.6)	57.6(21.5)	15.0(5.6)	70.4(26.2)	268.2
Kansas	75.8(35.4)	32.7(15.3)	40.5(18.9)	14.6(6.8)	50.7(23.7)	214.3
Kentucky	79.5(26.4)	71.0(23.6)	64.5(21.4)	25.1(8.3)	61.2(20.3)	301.3
Louisiana	85.4(18.5)	34.2(7.4)	63.5(13.7)	47.7(10.3)	232.0(50.1)	462.8
Maine	28.5(31.6)		23.7(26.3)	9.1(10.1)	28.8(32.0)	90.1
Maryland	76.8(21.4)	110.9(30.9)	57.5(16.0)	20.0(5.6)	93.8(26.1)	359.0
Massachusetts		190.6(36.3)	79.2(15.1)	68.1(13.0)	187.5(35.7)	525.4
Michigan	390.1(40.2)		148.3(15.3)	90.5(9.3)	340.3(35.1)	969.2
Minnesota		134.5(35.1)	58.0(15.1)	41.8(10.9)	148.7(38.8)	383.0
Mississippi	71.7(36.6)	20.5(10.5)	46.8(23.9)	16.0(8.2)	40.9(20.9)	195.9
Missouri	124.7(36.6)	58.9(17.3)	47.0(13.8)	18.7(5.5)	91.6(26.9)	340.9

TABLE 3 (Continued)

State	General Sales Taxes	Personal and Corporate Income Taxes	Motor Fuel Taxes	Tobacco and Alcohol Taxes	Other Taxes	Total State Taxes
Montana		18.3(26.6)	17.4(25.3)	10.0(14.6)	23.0(33.5)	68.7
Nebraska			38.5(40.8)	9.6(10.2)	46.2(49.0)	94.3
Nevada	13.8(28.8)		8.0(16.7)	3.0(6.3)	23.2(48.3)	48.0
New Hampshire		1.6(3.7)†	13.6(31.5)	5.5(12.7)	22.5(52.1)	43.2
New Jersey		26.4(6.8)*	100.1(26.0)	69.7(18.1)	189.5(49.1)	385.7
New Mexico	35.9(28.9)	7.4(6.0)	24.9(20.0)	6.9(5.6)	49.1(39.5)	124.2
New York		1,082.8(51.9)	221.9(10.6)	87.1(4.2)	695.0(33.3)	2 086.8
North Carolina	89.8(18.7)	149.1(31.1)	104.0(21.7)	17.9(3.7)	118.6(24.7)	479.4
North Dakota	15.7(25.2)	6.2(10.0)	13.2(21.2)	6.8(10.9)	20.4(32.7)	62.3
Ohio	254.3(29.2)		214.0(24.6)	98.0(11.3)	304.7(35.0)	871.0
Oklahoma	58.2(20.4)	32.6(11.4)	59.9(21.0)	26.3(9.2)	108.2(37.9)	285.2
Oregon		105.4(52.7)	38.2(19.1)	1.4(0.7)	55.0(27.5)	200.0
Pennsylvania	386.9(32.0)	154.3(12.8)*	165.9(13.7)	128.1(10.6)	373.3(30.9)	1,208.5
Rhode Island	24.6(25.8)	8.9(9.3)*	17.1(17.9)	10.4(10.9)	34.3(36.0)	95.3
South Carolina	68.7(28.7)	49.3(20.6)	51.8(21.7)	28.8(12.0)	40.5(16.9)	239.1
South Dakota	16.5(29.2)	.5(0.9)*	15.4(27.2)	6.1(10.8)	18.1(32.0)	56.6
Tennessee	106.8(34.4)	27.1(8.7)	77.8(25.0)	27.2(8.7)	72.5(23.3)	311.4
Texas	‡		189.1(23.4)	127.7(15.8)	490.1(60.7)	806.9
Utah	29.4(28.8)	21.7(21.3)	20.8(20.4)	3.3(3.2)	26.9(26.3)	102.1
Vermont		14.2(30.9)	8.6(18.7)	7.8(17.0)	15.3(33.3)	45.9
Virginia		110.6(32.1)	90.4(26.3)	33.7(9.8)	109.6(31.8)	344.3
Washington	268.6(56.3)		63.6(13.3)	32.3(6.8)	112.9(23.6)	477.4
West Virginia	85.8(46.2)	.9(0.5)†	33.2(17.9)	12.7(6.8)	53.2(28.6)	185.8
Wisconsin	‡	201.3(45.6)	75.2(17.0)	37.2(8.4)	127.5(28.9)	441.2
Wyoming	11.8(28.6)		7.8(18.9)	2.4(5.8)	19.2(46.6)	41.2
Total	$4,509.5(23.7)	$3,620.9(19.0)	$3,431.2(18.0)	$1,689.1(8.9)	$5,806.8(30.4)	$19,057.5

SOURCE: Bureau of the Census, *Compendium of State Government Finances in 1961.*
*Corporation income tax only.
†Individual income tax only.
‡Adopted sales tax during 1962 fiscal year.

From its inception the sales tax has been the big provider at the state level in Illinois. Table 4 shows the relationship between sales tax revenue and other state taxes on a total, per capita, and percent of personal income basis for selected years from 1931 to the present. After the rate was raised to 3.0% in 1935, the sales tax provided over 50% of the state's tax revenue. When the rate was lowered in 1941 its relative importance declined, but not below 40% during most years. Even though the rate increased to 3.0% by 1961, the sales tax did not increase significantly in importance primarily because of substantial gains in motor fuel and license, alcohol and cigarette taxes. However, it can be expected that with the increase in rate to 3.5% and broadening of tax base (discussed in the next section) the sales tax will again provide over 50% of Illinois' state tax revenue in the fiscal year 1962.

While the per capita burden of the sales tax has increased substantially since the 1930's, the burden of the tax in relation to taxpayers' income was about the same in 1961 as in the early years of the tax. Of course, this burden will rise in 1962, but it should not exceed 2% of the personal income of Illinois residents. The significance of this figure lies in pointing out that the tax burden at the state level has increased relatively little, if any, during the past three decades, a fact contrary to the common conception. Quite naturally, sales and other tax payments were down relatively during World War II and the post-war period, and while tempting, these years ought not be used for a meaningful comparison with today's taxes to determine increases in the tax burden.

The Sales Tax Base

Basically, the sales tax is a tax on the transfer of tangible property or services. If that tax is on the transfer of a particular type of property or service, one would call it an excise or selective sales tax; if the tax applies to a broad range of transfers, it would be more properly termed a general sales tax. Since all states use some selective taxes, motor fuel for example, it is clear that the state sales taxes referred to in the previous section were general sales taxes. I will adopt that convention hereafter and use the terms sales tax and general sales tax interchangeably.

Since thirty-seven states currently use the sales tax it is safe to say that there are at least thirty-seven different sales taxes at work in the United States today. While each state tax is different, tax analyists find it convenient to categorize sales taxes into various groups according to points of similarity or dissimilarity in coverage or base of the taxes.

Types of Sales Taxes

Sales taxes may be classified as to the legal nature of their impact on taxpayers. Some sales taxes are imposed directly on the purchaser in each transaction; the seller is officially a tax collector for the state. In most such cases, the tax must be kept separate from the selling price and shifting of the tax to the purchaser is mandatory. In other states the sales tax is imposed on the seller, or retailer in most cases, for the privilege of doing busi-

TABLE 4

Growth of State Taxes in Illinois

Year	All State Taxes			General Sales Taxes			General Sales Taxes As a Percent Of All State Taxes
	Total (In Thousands)	Per Capita	As a Percent of Personal Income	Total (In Thousands)	Per Capita	As a Percent of Personal Income	
1931	$110,626	$14.39	2.13%	$	$	%	%
1937	152,589	19.41	2.66	77,217	9.82	1.34	50.6
1941	209,739	26.66	2.98	110,699	14.02	1.57	52.8
1946	256,846	33.27	2.17	107,378	13.91	.91	41.8
1950	379,765	44.03	2.51	166,951	19.35	1.10	44.0
1955	551,823	60.03	2.66	205,532	22.36	.99	37.2
1958	735,090	75.79	3.11	319,308	32.92	1.35	43.4
1961	874,310	85.23	3.26	383,957	37.43	1.43	43.9

SOURCE: Bureau of the Census, *Compendium of State Government Finances* (1931-1961).

ness. While shifting to the purchaser undoubtedly occurs, the impact of the tax is officially on the seller. As Due points out, this classification might be misleading, because many states have hybrid taxes in the sense that they exhibit characteristics which lend well to both classes.[2] Due considers the privilege tax to be superior in toto because of greater flexibility and fewer problems with classification of buyers into exempt and nonexempt categories. The distinction is not fraught with great economic consequences, however, and beyond occasional reference will not play a large part in this study.

The sales tax may also be classified according to its line of attack, either multi-stage or single-stage. A multi-stage sales tax falls on more than one stage of the production process, the manufacturing, wholesaling, and retailing of goods. On the other hand, a single-stage tax falls on only one level in the production process. For the most part, states have single-stage taxes at the retail level; however, a few deviations might be noted. Indiana covers all stages of the production process—even the supplying of labor—with its gross income tax, and West Virginia applies varying rates on the gross income of most lines of business. New Mexico, Arizona, Hawaii, Mississippi, and Washington apply low tax rates to selected phases of the production process such as wholesaling, mineral extraction, or processing. After this brief mention of multi-stage elements which exist in a few states, this study will concentrate on the single-stage sales tax at the retail level, or retail sales tax.

Scope of the Retail Sales Tax

Even retail sales taxes have very different bases. Some are generally broad, that is, cover wide ranges of commodities and services, while others exclude broad areas from the tax. One can view the general scope of state sales tax bases by looking at the yield of each state's tax after allowances for differing tax rates and taxpayers' incomes. Table 5 shows the per capita yield of the sales tax, per capita yield per 1% of tax rate, and per capita yield per 1% of rate as a percent of per capital personal income of residents, for each of the sales tax states. The yield shown for each state includes only revenue realized from the tax at the retail level; revenue resulting from non-retail elements of some state taxes has been excluded for purposes of Table 5.

In general, the sales tax base gets narrower as one goes down the list of states in Table 5; Hawaii has the broadest based tax, New Mexico the second broadest, and so on to Maryland which has the narrowest tax base. While this is generally true, the precise order of the states is affected by factors other than the breadth of tax base. Florida and Nevada, for instance, collect substantial amounts of tax from tourists and probably have narrower tax bases than Table 5 would indicate. Connecticut taxpayers spend a con-

[2] John F. Due, *State Sales Tax Administration* (tentative), forthcoming from the Public Administration Service.

siderable amount of their incomes in New York, and Connecticut might therefore have a broader tax base than indicated. Illinois residents vacation a good deal in Wisconsin and Michigan; but on the other hand, Chicago is the large shopping and convention center for the Middle West. The effect in Illinois cannot be readily determined. Despite these factors, it is safe to say that as of 1961, states such as New Mexico, Mississippi, and Utah have broadly based taxes; Kansas, Missouri, and Michigan have medium range bases; and Illinois, Pennsylvania, Ohio, and Maryland have narrow tax bases. Because of tax broadening undertaken in 1962 some states, Illinois in particular, probably now have broader tax bases than shown in Table 5.

One can bear out these relationships by examining the sales tax laws and rules in the various states. New Mexico, for example, taxes a broad range of services in addition to sales of personal property and real estate contracts and transient and permanent room rentals. Hawaii, Mississippi, Utah, and Arizona cover a similarly broad range of transactions. On the other hand, most states in the middle and lower range in Table 5 exclude most services and real property contracts from the tax in addition to special categories such as food.

Exemption of food in good part accounts for the low ranking of nine states since food makes up a good share of the sales tax base, up to 20% in some states. Even with food exemption, California, Florida, and Maine had broader based taxes in 1961 than Illinois which taxes food. If Rhode Island, North Carolina, and perhaps Pennsylvania and Ohio, taxed food their tax bases would apparently become broader than Illinois, leaving that state in the lower five from the standpoint of breadth of sales tax base in 1961. If the yield of Illinois' tax on public utility services were included with sales tax yield, as it might well be, Illinois would rank slightly higher than shown in Table 5.

In most states the sales tax is basically a tax on the sale—or privilege of selling—tangible personal property at retail. Two questions immediately arise: (1) what is a sale at retail? and (2) what is tangible personal property? The different scope of the sales tax in many states arises directly from different answers to these two questions.

Sales at Retail

A sale at retail may be thought of as a sale to the final user or consumer of the product sold. This definition clearly eliminates sales of merchandise to stores which intend reselling the goods to their customers. The stores in this case are not final users, but intermediaries in the process of distributing goods from the producer to the final consumer. On the other hand, the housewife who visits that store and purchases a swim suit, lawn chair, or what have you, clearly purchases for final consumption; such sales would be taxable under a retail sales tax. All states would agree in these clear cut cases.

TABLE 5

Per Capita Yields of State Sales Taxes in 1961

State	Per Capita Yield	Per Capita Yield Per 1% Of Tax Rate	Per Capita Yield Per 1% Of Tax Rate As a Percent Of Per Capita Personal Income
Hawaii	$89.15	$25.47	1.12%
New Mexico	36.01	18.00	1.00
Mississippi	32.90	10.96	.93
Utah	32.85	16.42	.86
Arizona	51.17	17.06	.85
Nevada	48.04	24.02	.84
Louisiana	26.01	13.50	.84
Georgia	37.49	12.49	.78
Arkansas	31.11	10.38	.77
Wyoming	35.68	17.84	.76
Washington	71.34	17.58	.76
Iowa	30.15	15.07	.75
North Dakota	24.74	12.37	.71
South Carolina	28.73	9.58	.69
Kansas	34.81	13.92	.67
Oklahoma	24.94	12.43	.67
South Dakota	24.24	12.12	.67
Missouri	28.79	14.39	.65
Colorado	29.68	14.84	.64
Michigan	49.71	14.84	.64
Tennessee	29.88	9.96	.64
Alabama	27.83	9.28	.63
Kentucky	26.10	8.70	.56
*California	45.10	15.03	.55
*Florida	31.04	10.35	.52
*Maine	29.30	9.73	.51
Illinois	37.96	12.65	.48
West Virginia	18.66	8.04	.48
*Rhode Island	28.76	9.59	.43
*North Carolina	19.68	6.56	.42
*Pennsylvania	34.11	8.53	.38
*Ohio	26.11	8.70	.37
*Connecticut	31.23	10.41	.36
*Maryland	24.64	8.21	.34

SOURCE: John F. Due, *State Sales Tax Administration* (Tentative), forthcoming from the Public Administration Service; Hawaii data from the Hawaii Department of Taxation; personal income data from the Department of Commerce.
*Indicates state has food exemption.

But what about the sale of flour to a baker who intends converting that flour into bread which will be sold to his customers? Clearly, the baker is the final user of the flour as such; but states would agree that such a sale—flour to a baker—is not a sale at retail, but rather, a sale for resale. Thus, all states have adopted some form of the *ingredient rule*. A sale of goods which become the ingredients or component part of other goods which will be sold does not constitute a sale at retail, and is hence not taxable. Although borderline cases naturally arise for which courts in different states have different answers, the ingredient rule is generally followed by all sales tax states.[3]

While the ingredient rule meets with general agreement, states part company on the question of sales of industrial and agricultural machinery. Is a baker the final user of the oven in which he bakes his bread? Michigan, Missouri, Ohio, Oklahoma, Pennsylvania, South Carolina, and West Virginia would say no, while the other states would say yes. Michigan, for example, adopts the *direct-use rule;* that is, sales of goods such as machinery, fuels, etc., which are used directly in the industrial or agricultural production process are not sales at retail. This raises the inevitable question, what is direct use? Clearly, the baker uses his oven directly in the production process; and almost as clearly, the general manager's air conditioner is not used directly. But within these constraints a host of questions can arise.

Strictly speaking, sales to industrial and agricultural processors, and retailers and wholesalers generally, whether the goods are for resale or are ingredients or tools to be used directly or indirectly in the production process, ought not to be considered retail sales if the sales tax is to be truly a single-stage tax. From an economic standpoint there is little to distinguish the flour from the oven. (The manager's air conditioner may be a luxury designed to keep him happy, and hence, little different from his home air conditioner; on the other hand, it may improve his productivity.) Nonetheless, most states apply the sales tax to all industrial and agricultural equipment—the "oven"—while excluding ingredients—the "flour." While exclusion of all sales to business concerns, whether ingredients or not, from the sales tax would be the wisest course on economic grounds, such a course might open up a host of evasion possibilities and would seriously limit the base of the sales tax. Table 6 provides a summary of each state's treatment of agricultural and industrial raw materials and equipment as well as other commodities which will be discussed later.

Tangible Personal Property

Most states single out tangible personal property when applying the sales tax. Presumably, tangible property is any commodity which can be felt, seen, or held—something of substance. However, when one buys such a commodity he is really buying a bundle of services, partially embodied in the physical commodity itself. He is buying the services of a salesman who

[3] Indiana taxes all such sales with their gross income tax, but that does not pretend to be a retail sales tax.

TABLE 6

Selected Items Taxable Under State General Sales Taxes

Legend: T, Taxable; N, Not Taxable

State	Food for Human Consumption			Agricultural		Industrial				
	On Premises	Off Premises	Medicine	Materials*	Machinery	Materials†	Machinery	Cigarettes‡	Alcoholic Beverages‡	Motor Fuels‡
Alabama	T	T	T	N	T	N	T§	T	T	N
Arizona	T	T	T	N	T	N	T	T	T	N
Arkansas	T	T	T	N	T	N	T	N	T	N
California	T	N	T¶	N	T	N	T	T	T	N
Colorado	T	T	T	N	T	N	T	N	N	N
Connecticut	T•	N	N¶	N	T	N	T	N	T	N
Florida	T	N	N	N	N	N	T**	T	T	N
Georgia	T	T	T	N	T	N	T	T	T	T
Hawaii	T	T	T	N	T	N	T	T	T	T
Illinois	T	T	T	N	T††	N	T††	T	T	T
Indiana	T	T	T	T	T	T	T	T	T	T
Iowa	T	T	T	N	T	N	T‡‡	T	T	T§§
Kansas	T	T	T	N	T	N	T	N	N	N
Kentucky	T	T	T	N	T	N	T¶¶	T	T	N
Louisiana	T	T	T	N	T	N	T	T	T	N
Maine	T	N	N¶	N	T	N	T	N	N	N
Maryland	T•	N	N	N	T	N	T	T	T	N
Michigan	T	T	T	N	N	N	N	T	T	T
Mississippi	T	T	T	N	T†††	N	T••	T	T***	T
Missouri	T	T	T	N	T	N	N	T	T	N
Nevada	T	T	T	N	T	N	T	T	T	N
New Mexico	T	T	T	N	T†††	N	T	T	T	N

TABLE 6 (Continued)

State	Food for Human Consumption: On Premises	Food for Human Consumption: Off Premises	Medicine	Agricultural: Materials*	Agricultural: Machinery	Industrial: Materials†	Industrial: Machinery	Cigarettes‡	Alcoholic Beverages‡	Motor Fuels‡
North Carolina	T	T	T	N	T†††	N	T†††	T	T***	N
North Dakota	T	T	N¶	N	T	N	T	N	N	N
Ohio	T	N	T	N	N	N	N	N	T‡‡‡	N
Oklahoma	T	T	T	T§§§	T††	N	N	N	T	N
Pennsylvania	T•	N	N¶	N	N	N	N	N	T	N
Rhode Island	T	N	N	N	T	N	T	N	T	N
South Carolina	T	T	T	N	N	N	N	T	T	N
South Dakota	T	T	T	T§§§	T	N	T	N	N	N
Tennessee	T	T	T	N	T	N	T¶¶	N	T	N
Texas	T	N	N	N	N	N	T	N	N	N
Utah	T	T	T	N¶¶¶	T	N	T	T	T	N
Washington	T	T	T	N	T	N	T	T	T	N
West Virginia	T	T	T	N	N	N	N	T	T	N
Wisconsin	T	N	N	N	N	N	N	T	T	N
Wyoming	T	T	T	N	T	N	T	N	N	N

SOURCE: Tax Foundation, Inc., *Retail Sales . . .*, Table 8. Commerce Clearing House, *Wisconsin State Tax Reporter*.

*Generally includes fertilizers, feedstuffs, seeds, insecticides, and other materials used in agricultural production.

†Generally includes raw materials becoming a physical ingredient or component part of a product destined for sale, and non-returnable containers and labels used in manufacturing.

‡All states impose a selective sales tax on motor fuels, alcoholic beverages and, with the exception of Colorado, North Carolina and Oregon, on cigarettes. In case of alcoholic beverages, monopoly states usually impose a mark-up on sales in state stores.

§Subject to 1.5% tax.

¶Exemption applies to prescription medicine only; in California, exemption will begin January 1, 1962.

•Excludes meals under $1.00 n Connecticut and Maryland, and $.50 and under in Pennsylvania.

**Maximum tax on industrial machinery is $1,000.

††Trade-in allowance on machinery excluded from sales price.

‡‡Industrial equipment not readily obtainable in the state is exempt.

§§Gas sold for non-highway use only.

¶¶Machinery installed for new and expanded industry is exempt in Kentucky and taxed at 1% in Tennessee.

••Sales in excess of $500 of industrial machinery to be used within Mississippi are exempt.

***Beer and light wine only.

†††Subject to 1% tax in New Mexico and North Carolina; farm tractors taxed at 1% in Mississippi.

‡‡‡Distilled spirits only.

§§§Feed exempted.

¶¶¶Seed taxed if used to grow foodstuffs.

informs, perhaps; or a one-year guarantee of free service; or free installation. The price of these services is normally included in the selling price attached to the commodity. Should the sales tax apply to the full price? Or should the cost of the named services be deducted before the tax is applied? If so, how about the cost of shipping services, packaging services, production services? If this policy were carried to the extreme the tax base would wither away completely, since all payments for commodities wind up in someone's hands for having provided a service, either labor or the supplying of capital. In the interests of having something to tax, however, the selling price of the commodity, less cash discounts and the like, is usually set as the base for taxation. In some instances, such as repairs, the service element seems essentially separate from the materials, and a common treatment is to tax only the materials if labor charges are kept separate.

While all states have borderline difficulties with the definition of tangible property, Illinois faces a special problem in this regard. Illinois courts have ruled that some commodities, custom-made articles, books, sheet music, and the like, are so dominated by the service element as to be ruled not tangible personal property for purposes of the sales tax. Many of these items were put on the tax rolls by the 1962 broadening act, but because this loophole still embraces most industrial machinery on custom made grounds, the sales tax base has been seriously diminished.

At the heart of the problem of defining tangible property, in Illinois and elsewhere, is the sometimes deferential treatment accorded services. There is no good economic reason why tangible property should be singled out for taxation and services by-passed. After all, tangible commodities are useful only because of the services they provide. As a case in point, why should automatic washing machines be subject to the sales tax when cleaning services are not so subject? The machine and the cleaners provide essentially the same service, cleaning of clothes; the only difference is that the necessary labor is do-it-yourself in one instance and purchased in the other. If services were subject to the same tax as commodities, the administrative problem of defining tangible property would be significantly reduced. Also, the tax would be much improved on equity grounds (to be discussed in the next section) if services were included in the sales tax base.

Treatment of Services

Some states include a wide variety of services in the sales tax base, either as part of the basic sales tax law or by special enactment. New Mexico, for instance, taxes virtually all services including professional services of doctors and lawyers. West Virginia has a similarly broad coverage, but excludes professional and personal services. Other states which have a broad coverage of services include Mississippi, Louisiana, Utah, and Washington. On the other hand, California and Nevada entirely exclude services (except commodity rentals in California) from the sales tax base. Many states tax selected services by special enactment. A common one is admis-

TABLE 7

Sales Taxation of Selected Services

Legend: T, Taxable; N, Not Taxable

State	Admissions	Repairs	Laundry and Dry Cleaning	Transient Rooms	Commodity Rentals	Public Utilities
Alabama	T	N	N	T	N	N
Arizona	T	N	N	T*	T	T†
Arkansas	T	N	N	T	T	T‡
California	N	N	N	N	T	N§
Colorado	N	N	N	T	T	T§
Connecticut	N	N	N	T	T	N
Florida	T	N	N	T	T	N
Georgia	T	N	N	T	T	T¶
Hawaii	T	T	T	T	T	T‡‡
Illinois	N	N	N	T	N	T†, §
Iowa	T	N	N	N	T	T‡
Kansas	T	N	N	T	T	T§
Kentucky	T	N	N	T	T	T‡
Louisiana	T	T	T	T	T	N
Maine	N	N	N	T	N	T•
Maryland	N	N	N	T	T	T**
Michigan	N	N	N	T	T	T**
Mississippi	T	T	T	T	T	T††
Missouri	T	N	N	T	N	T††
Nevada	N	N	N	N	T	N
New Mexico	T	T	T	T*	T	T‡‡

TABLE 7 (Continued)

State	Admissions	Repairs	Laundry and Dry Cleaning	Transient Rooms	Commodity Rentals	Public Utilities
North Carolina	N	N	T	T	T	N
North Dakota	T	N	N	N	N	T‡
Ohio	N	N	N	T	T	N
Oklahoma	T	N	N	T	T	T¶
Pennsylvania	N	T	N	T	T	T§§
Rhode Island	N	N	N	N	N	T‡
South Carolina	N	N	T	T	T	T¶¶
South Dakota	T	N	N	N	N	T‡
Tennessee	N	N	N	T	T	N
Texas	N	N	N	T	T	T
Utah	T	T	T	T	T	T¶
Washington	N	T	T	T	T	T†
West Virginia	T	T	T	T	T	N
Wyoming	N	N	N	N	T	T¶
Wisconsin	T••	N	N	T	T	T§§

SOURCE: John F. Due, *Sales Tax Administration;* Commerce Clearing House, *Wisconsin State Tax Reporter;* Hawaii Departement of Taxation.
*Also tax permanent rentals of people engaged in the business of renting real property.
†Special levy in lieu of sales tax.
‡Water, gas, electricity, telephone, telegraph.
§Gas, electricity, telephone, telegraph.
¶Gas, electricity, telephone, telegraph, passenger transportation.
•Water, gas, electricity.
**Gas, electricity.
††All utilities except freight transport.
‡‡All utilities.
§§Telephone, telegraph.
¶¶Telephone, telegraph, electricity.
••Admissions to motion pictures costing less than 75 cents are exempt.

sions which are taxed in eighteen states; another is transient room rentals taxed in twenty-six states.[4] Table 7 summarizes the treatment of selected services by the sales tax states.

Real Property

While most states do not tax real property as such, seven—Arizona, Maryland, Mississippi, New Mexico, Hawaii, Utah, and Washington—apply the sales tax in varying forms, and usually at reduced rates, to the entire construction contract. The remaining states, except West Virginia and Wisconsin which do not tax real contracts or sales to contractors, treat contractors as consumers of tangible personal property and apply the sales tax to the sale of building materials to the contractors. If this tax is shifted to the home buyer, and there is little reason to suppose it is not, the effect of taxing the sale of building materials to contractors is essentially the same as taxing the real contract at half the basic rate, as is done in Mississippi, since approximately 50% of housing costs represents materials. The effect of taxing materials is also similar to that achieved in Arizona where direct labor is deducted from the contract price before the tax is applied.[5]

Exemptions

Some states specifically exempt certain classes of commodities or types of transactions from sales taxation. As indicated in Table 6 many states exempt cigarettes, alcoholic beverages, or motor fuel, mainly on the grounds that selective state sales taxes have already been applied thereto and application of the general tax would amount to double taxation or a tax upon a tax. Some states avoid the tax upon a tax charge by excluding the amount of selective sales tax from the general sales tax base.

Ten states specifically exempt food for home consumption from the sales tax, usually on equity grounds. A food exemption significantly reduces the sales tax base since it accounts for a large part of consumption expenditures, and accounts in good measure for the narrow tax base in most of the exempting states. Other items commonly exempted from the sales tax are prescription medicines, periodicals, and casual sales made by individuals not in the business of selling.

Sales to government agencies and non-profit institutions are subject to a variety of treatments by sales tax states. Fourteen states, including Illinois, Michigan, and Ohio, exempt all bona fide charitable, educational, and religious institutions. Eight, including Iowa and California, offer no such exemption, while the remaining states provide for partial exemption, such as educational institutions only in Alabama and religious organizations only in Oklahoma and Wyoming. All states, except South Carolina and Illinois, exempt sales to the federal government and its contractors. Nine states tax sales to their own state agencies and seven of these, including Illinois and

[4] See John F. Due, *Sales Tax Administration* for a more complete treatment of taxation of services.

[5] Again, see Due for a more detailed description of the treatment of real property.

California, extend the tax to sales to local units of government. All other states exempt sales to state and local bodies.

The Sales Tax Base in Illinois

The Illinois Retailers' Occupation Tax (ROT) is imposed upon the privilege of selling tangible personal property at retail. In general, Illinois follows the ingredient rule and excludes sales of all goods which physically become a part of other goods for resale, but taxes all other sales of tangible personal property to businesses. Feed, seed, and fertilizer sold to farmers are excluded as ingredients, but sales of agricultural machinery are fully taxable.

The Service Occupations

The uniformity provision of the Illinois constitution prevents the state from exempting specific commodities from the sales tax.[6] Nonetheless, the courts have interpreted sale at retail and tangible property in such a manner as to exclude broad ranges of commodities from the tax. Shortly after the ROT was enacted in 1933, a host of occupations paraded themselves through the courts claiming to be service oriented and hence their sales should not be subject to the tax. In many instances, the Illinois courts ruled that materials transferred were incidental to the service and excluded the entire transaction from the tax.

To compound the difficulty with the so-called service occupations the Illinois Supreme Court also ruled that materials transferred by service occupations as an incident to their services were not consumed by those occupations. This ruling meant that sales of materials to the service occupations were not taxable either. The net effect of the courts' interpretations of sale at retail and tangible personal property was to exempt the sales of service occupations as well as their purchases of materials for transfer to customers. Among the goods and occupations so shielded from the ROT by the courts were: photographers, blueprinters, and photoengravers; printers and electrotypers; dentists, physicians and optometrists; repairmen generally: funeral directors; newspapers, periodicals, and sheet music; monuments and memorials; neon signs and canopies; pharmacists; custom tailors; special machines, tools, dies, patterns, and other custom made equipment; barbers and beauticians; and until recently, construction contractors. The *1949 Report of the Revenue Laws Commission* contains a more detailed list of occupations and goods excluded from the tax base because of the service element and the court cases establishing the precedents.[7] No attempt will be made to duplicate that effort in this report.

The Department of Revenue has been primarily concerned with the exclusion of machine tools and building materials because of the vast revenues that have been lost to the state from these sources: an estimated $90

---

[6] The first sales tax act passed in 1932 was ruled unconstitutional because it violated uniformity by exempting motor fuel and farm products from taxation. *Winter* v. *Barrett*, 352 Ill. 441 (1933).

[7] Paul E. Malone, "The Sales Tax," *Report of the Revenue Laws Commission of the State of Illinois* (Springfield, 1949).

million in tax revenue was lost in 1960 alone. Since 1940 the Department of Revenue and the General Assembly have made numerous attempts to reach the service occupations with the ROT, but not until 1961 was significant progress made. That year the legislature broadened the ROT to include sales of custom clothing, drapes, eyeglasses, carpeting and monuments. These and other items formerly excluded on custom-made grounds are now taxable under the ROT at the full selling price. Also fully taxable are sales of books, periodicals, records, and sheet music.[8] Commodity rentals were also covered under the the broadened ROT, but the Illinois Supreme Court has recently ruled that part of the ROT amendment invalid.[9]

The General Assembly also enacted a Service Occupation Tax (SOT) which applies to materials purchased by predominantly service occupations for transfer as an incident to their services. Among the goods and occupations covered by the SOT are: paper and ink purchased by printers; metal and other ingredients purchased by special machine, tool, die, and pattern makers who incorporate such materials into special products still exempt from the ROT on custom-made grounds; physicians supplies; purchases of drugs for prescription sale by pharmacists; dentists' supplies; and purchases of hair tonics and lotions by barbers and beauticians for use on customers.[10]

In *Lyons and Sons Lumber and Manufacturing Co.* v. *Dept. of Revenue*[11] the Illinois Supreme Court reversed a long standing precedent and ruled that construction contractors are final users and consumers of building materials incorporated in real property; as a result, sales of building materials to contractors are now taxable under the ROT. Many aspects of the new SOT and broadened ROT, as well as the new treatment of contractors, are still in litigation, and their full impact on the tax base cannot yet be stated with certainty. To date, the 1961 broadening of the tax base has not brought in the anticipated revenue. This probably indicates that many taxpayers are waiting to see the results of litigation before obligating themselves to pay the tax.

A General Tax on Services

Illinois' difficulties with the service occupations arise because of the special treatment accorded services in the application of the sales tax. If the ROT could be changed to become a tax on the business of selling tangible personal property *and services* at retail—or a separate general service tax could be enacted—many of the current difficulties would dissolve. A maker of custom machinery must either sell a service or sell tangible personal property, and the question of which would become essentially immaterial since either sale would be taxable.

At present, the only services subject to a sales tax in Illinois, all by

[8] The Department of Revenue of the State of Illinois, *Rules and Regulations Relating to the Retailers Occupation Tax*, 1962.
[9] *International Business Machine Corporation* v. *Department of Revenue*, 25 Ill. 2d 503 (1962); *Crane Construction Co.* v. *Symond Clamp Co.*, 25 Ill. 2d 521 (1962).
[10] The Department of Revenue of the State of Illinois, *Rules and Regulations Relating to the Service Ocupation Tax*, 1962.
[11] 23 Ill. 2d 180 (1961).

special statute, are public utilities—gas, electricity, and messages—and transient room rentals (other commodity rentals come under the ROT). A general service tax would do away with the need for these special enactments as well as the present Service Occupation Tax. The title Service Occupation Tax is misleading since that tax does not apply to sales of services, but rather, to purchases of tangible personal property by service occupations. The effect of adopting a general service tax would be to give Illinois a significantly broader sales tax base and, hence, move it toward the top of the list in Table 5.

Several constitutional questions immediately arise in this regard. Could one sales tax law be designed to cover sellers of both services and tangible personal property? The advantages of having one sales tax law are obvious: easier reporting—only one tax form, for instance—and easier administration. However, Article 14, Section 13, of the Illinois State Constitution prohibits acts of the legislature from embracing more than one subject, and there is some question as to whether a tax on both goods and services would cover more than one subject. If it were decided that a single law would not be approved by the courts a separate general sales tax on services would probably be constitutional, provided that it did not exempt specific services from the tax. A good deal of legislative care would be required, however, to apply the tax solely to the *business* of selling services, and hence exclude wage and salary earners lest the tax become more of a gross income tax rather than a retail sales tax on services.

In order not to conflict with uniformity provisions of the Illinois Constitution, a general tax on services might have to cover professional services —doctors, dentists, lawyers, public accountants, etc.—and it may be objectionable to some people on those grounds. Under this circumstance, if the General Assembly should desire a sales tax on services to cover only specific occupations, such a tax would probably have to be accomplished by individually enacted privilege taxes on each of those occupations. If the service occupations were enumerated specifically in one act, it might violate the one-subject rule of the state constitution; whereas, a general tax with exemptions might violate the uniformity provision. A host of individual acts calling for a host of forms and reports would make for difficult compliance and administration and, on those grounds at least, make such a legislative program inferior to a general sales tax on service occupations. Some tax experts have indicated that it may be possible to define service in such a manner that professions would be excluded from an otherwise general service tax. If such a tax is desired, this type of general coverage would be preferable to a multiplicity of individual taxes.

Nonprofit Institutions

Since the broadening of the tax base in 1961, all sales by nonprofit organizations, other than primarily religious, charitable, or educational organizations, have been subject to the ROT whether the sales are to mem-

bers or to the general public. All purchases of goods by such nonprofit organizations are also subject to the ROT if the goods are not for resale. When an organization can qualify as primarily religious, charitable, or educational, all sales to and by such an organization are exempt from the ROT (except when goods are sold to the public in competition with taxable retailers). Prior to 1961, many nonprofit institutions, such as lodges, fraternities, and clubs, were exempt as to their sales to members and purchases of goods for resale. This change has markedly improved the administration of the sales tax as well as made the tax more equitable.

Sales to Governmental Units

Prior to 1961, sales to the state and local units of government were exempt from the ROT, while sales to the federal government were taxable. In *United States and Olin Mathieson Chemical Corp.* v. *Department of Revenue of Illinois*[12] the district court held that such treatment was discriminatory and issued an injunction against the collection of taxes on sales to the federal government. In order to remove the objections of the court, the Illinois legislature broadened the ROT to cover sales to state agencies and local units. In a re-run of the Olin Mathieson case the district court and later the United States Supreme Court upheld the state's actions, and Illinois is again collecting taxes on sales to the federal government.[13]

The Sales Tax in Interstate Commerce

The interstate commerce and due process clauses of the United States Constitution have long posed a barrier to the application of state sales taxes to transactions with an interstate character. Federal courts have vigilantly guarded the rights of businessmen to deal in interstate commerce free of restrictive state taxes, and rightly so, because a free movement of goods between states is one of the cornerstones of our productive society. Nonetheless, the exemption of interstate transactions from the sales tax poses the problem of competitive inequality between those who do business within a state and those whose business takes them across state lines. The protection of interstate commerce also presents the possibility for willful evasion of the state sales tax by dealing out of state. In order to mitigate these problems, states have tried to extend the sales tax to interstate sales, and they have been somewhat successful in this regard.

It is well established that the Illinois ROT cannot be levied on sales of goods to be delivered across the state boundry for out-of-state use. On the other hand, if an Illinois seller delivers the goods to the purchaser in Illinois, the ROT must be applied even though the goods may be immediately removed from the state.[14] While some complications inevitably arise, the line is well drawn in this regard.[15]

As to sales of goods to Illinois purchasers by substantially out-of-state

---

[12] D. C., 191 F. Supp. 723 (1961).
[13] 202 F. Supp. 757 (1962).
[14] *Pressed Steel Car Co.* v. *Lyons*, 7 Ill. 2d 95 (1955).
[15] Willard Ice, "The Retailers' Occupation Tax Act and Related Tax Laws," University of Illinois, *Law Forum*, Vol. 1961, Winter Number, pp. 628-29.

sellers, the applicability of the ROT has been less clear. The Department of Revenue has succeeded in applying the sales tax when the seller has an office in Illinois and sales are consummated within the state, even though the goods are shipped from a point out of the state.[16] But, the Department has not been successful in applying the sales tax where the seller maintains no formal place of business in Illinois.[17]

Until 1944, the power of states to apply their sales taxes on substantially interstate sales had expanded as a result of a long line of cases.[18] There was good reason to hope that eventually the sales tax might be expanded to apply to any sale which was directly or indirectly solicited in a sales tax state and delivery made there, even though the sale might be consummated in another state. Such treatment would not have placed an undue burden on interstate commerce since only the state in which the goods are delivered could apply the sales tax. In *McLeod* v. *J. E. Dilworth Co.*,[19] however, the United States Supreme Court threw cold water on those aspirations by holding that the Arkansas sales tax could not be applied to sales of Tennessee firms which merely solicited business but had no formal office in Arkansas. As a result of this and other decisions, there was little hope of sufficiently extending the scope of the sales tax to interstate commerce, and many states, Illinois included, shifted their attention to the use tax.

The Use Tax

The primary function of the use tax is not to provide revenue directly, but to prevent the loss of revenue from avoidance of the sales tax and to remove inequalities between those individuals and businesses that buy within the state and those that buy from sellers outside the state. Nonetheless, the use tax provided $25.7 million to the State of Illinois in 1962, or more than five percent of the total sales tax yield in that year. Table 8 shows use tax collections in Illinois since its inception in 1955. The extreme variability of use tax collections is undoubtedly due to two factors: the bulk of all collections come from industrial equipment and automobiles purchased out of the state, both of which are notoriously unstable; and the settling of litigation which results in large irregular payments of tax.

Illinois has both a use tax as a complement to the ROT and a service use tax as a complement to the SOT. Since both use taxes have essentially the same bases as the taxes they complement, nothing further will be said about the bases of the use taxes.

California and Washington enacted the first use taxes in 1935. Since that time, all sales tax states have enacted a use tax, Illinois being one of

[16] *Department of Revenue* v. *Jennison-Wright Corp.*, 393 Ill. 401 (1946).

[17] *Automatic Voting Machine Corp.* v. *Daley*, 409 Ill. 438 (1951); *Norton Co.* v. *Department of Revenue*, 340 U. S. 534 (1951).

[18] *McGoldrick* v. *A. H. Du Grenier, Inc.*, 309 U. S. 70 (1940); *McGoldrick* v. *Berwind-White Coal Mining Co.*, 309 U. S. 619 (1940); *Wiloil Corp.* v. *Pennsylvania*, 294 U. S. 169 (1935); and others.

[19] 322 U. S. 127 (1944).

TABLE 8
Use Tax Collections in Illinois, 1956-1962

Fiscal Year	Tax Collections (In Thousands of Dollars)
1956	$10,170
1957	12,415
1958	22,563
1959	12,912
1960	20,448
1961	19,433
1962	25,727

SOURCE: Illinois Department of Revenue.

the last in 1955.[20] Originally, there were serious questions as to the compatibility of the use tax concept and the interstate commerce clause of the federal constitution. It was felt that the use tax was in reality a tax on the shipment of goods into a state and hence a tax on interstate commerce. In *Henneford* v. *Silas Mason Co., Inc.*[21] however, the United States Supreme Court laid these fears to rest by ruling favorably on the Washington use tax. While constitutionality of the use tax has been well accepted since the Silas Mason decision, states have had a long running battle in their attempts to enforce collection of use taxes by out-of-state sellers.

In general, the use tax can be collected from two sources, the seller of goods or the purchaser. In the case of automobiles, collection from the purchaser can be readily enforced; when the purchaser seeks a state title and license for a new car he must demonstrate payment of the state sales tax or else remit the use tax before title and license are granted. As applied to business concerns, especially large ones, that purchase goods out of state, collection of the use tax can be readily enforced through the audit program of the Department of Revenue. Concerns which purchase equipment in another state must remit the use tax; failure to do so can readily be uncovered during a sales tax audit. However, even in the case of business purchases, but especially in the case of out-of-state purchases by individuals, enforcement of the use tax would be markedly improved if the tax could be collected from the out-of-state seller.

Beginning in 1939 with *Felt and Tarrant Manufacturing Co.* v. *Gallagher*[22] down to the recent case of *Scripto, Inc.* v. *Carson*,[23] the United States Supreme Court has licensed an expanding program of state collection of use taxes from out-of-state sellers. The Scripto decision held that Florida

[20] Strangely, the Revenue Laws Commission of 1949 recommended that a use tax not be adopted at that time on the grounds that it would be difficult to administer, and furthermore, would likely be unconstitutional. These fears were apparently not well founded.

[21] 300 U. S. 577 (1937).

[22] 306 U. S. 62 (1939). As a result of this decision a foreign corporation doing interstate business was required to collect use tax for the State of California in its sales to purchasers in that state. This seller sold through two general agents located in California.

[23] 362 U. S. 207 (1960).

could force a Georgia firm to register and collect the Florida use tax even though that firm had no place of business or regularly employed salesmen in Florida. Scripto solicited business through independent jobbers who had no power to make contracts or deliver goods. In earlier cases the Supreme Court held that out-of-state mail order firms could be required to collect use taxes on mail order sales if they had a place of business in the use tax state;[24] and that soliciting by regularly employed salesmen was sufficient to enforce use tax collection of an out-of-state firm, even though that firm had no place of business in the state.[25]

As a result of this line of decisions, the Illinois General Assembly in 1961 broadened the Use Tax Act to enforce collection by out-of-state retailers who solicit business in Illinois by any form of advertising, even though no place of business is maintained in Illinois.[26] This format seems to extend beyond the Scripto case, and litigation is bound to arise; however, it is hoped that the state's position in this matter will be upheld.

Under the broadened Use Tax Act, the Department of Revenue has pushed for voluntary registration of out-of-state firms which solicit business in Illinois. This program reaches into St. Louis, Davenport, Wisconsin cities, and even as far as Indianapolis. Hopefully, this program would cover all major department stores and other major retailers who do a significant amount of business with Illinois residents. The Department of Revenue is also registering large industrial firms in the East which sell industrial equipment to Illinois firms. The Department has gone so far as to open a New York office with the intention of auditing firms which register to collect the Illinois use tax.

Currently, Illinois is trying to reach an agreement with border states, on a reciprocal basis, for the mandatory registration of use tax collectors. Such an agreement, under which Missouri (and other border states) would require its firms to register and collect the Illinois use tax in return for an Illinois requirement that its firms collect the Missouri use tax, would hasten compliance with the use tax and reduce the chances of damaging litigation. As of now, no agreement has been reached, however, and Illinois is continuing its program of voluntary registration. Thus far, 1906 out-of-state retailers who advertise in Illinois have voluntarily registered to collect the use tax under the 1961 broadening bill. This does not include the 756 firms who have registered as use tax collectors because they have formal places of business or regularly employ solicitors in Illinois.

Despite the progress in collecting the use tax from the seller, there is little the state can do to enforce the use tax on Illinois residents who cross the border to purchase goods and who take delivery in the other state. Of course, the purchaser must pay the other state's sales tax, but in all cases

---

[24] *Nelson* v. *Sears Roebuck & Co.*, 312 U. S. 359 (1941).
[25] *General Trading Co.* v. *State Tax Commission*, 322 U. S. 335 (1944).
[26] Previously, use tax collection had been required of firms which maintained a place of business in Illinois.

the rate is lower than that in Illinois, if a sales tax exists at all. This situation has made tax violators out of most of us, not only because of the tax saving, but also because of the nuisance and difficulty of reporting and paying such a tax. An exemption of such purchases from the use tax (some states do exempt small purchases) would be desirable to save individuals from the "self incrimination" of violating the Use Tax Act, but would probably make the tax unconstitutional on uniformity grounds.

The Equity of Sales Taxation

The hottest disputes about the sales tax revolve around its equity or the fairness with which it treats taxpayers. The overall equity of a tax can be considered in terms of (1) its vertical equity which refers to the treatment of taxpayers in different income groups; and (2) its horizontal equity which refers to the treatment of taxpayers with similar incomes.

Vertical Equity

The most common reason for condemning the sales tax has been its lack of vertical equity. The sales tax is a regressive tax, that is, the percentage of tax to taxpayer's income decreases as income increases; but the degree of sales tax regressivity is still disputed. This study will not attempt to specifically determine the degree to which the sales tax is regressive in Illinois, because a meaningful study of regressivity would involve a prohibitive amount of time and effort. Besides, many such studies have been performed which can generally be adapted to the Illinois situation.

TABLE 9

Various Studies of Sales Tax Regressivity

Income Group	Sales Tax As A Percent of Income California* (3.0% Tax)	21 Large† Cities (2.0% Tax)	Michigan‡ (3.0% Tax)	Washington§
Under $ 1,000	4.01%	2.2%	6.1%	3.89%
$1,000-$ 2,000	2.91	1.5		2.57
$2,000-$ 3,000	2.73	1.4	4.1	2.41
$3,000-$ 4,000	2.71	1.4	3.5	2.29
$4,000-$ 5,000	2.51	1.4	3.0	2.16
$5,000-$ 6,000	2.71	1.4	2.7	1.91
$6,000-$ 7,500	2.85	1.3		1.89
$7,500-$10,000	2.43	1.2	2.4	1.99
Over $10,000	2.09	.9	2.4	1.93

*William H. Hickman, *Distribution of the Burden of California and Other Excise Taxes* (Sacramento: State Board of Equalization 1958); hereafter referred to as the *California Study*. Based upon income after federal income taxes.

†David G. Davies, "An Empirical Test of Sales-Tax Regressivity," *The Journal of Political Economy*, February, 1959; hereafter referred to as the *Davies Study*. Based upon income after federal income taxes.

‡Richard A. Musgrave and Darwin W. Daicoff, "Who Pays the Michigan Taxes?" Michigan Tax Study, *Staff Papers* (Lansing, 1958). Based upon income after federal income taxes.

§Philip W. Cartwright, "Public Attitudes Toward Sources of State Revenue," *Natiinal Tax Journal*, December, 1949.

A summary of regressivity studies of the sales tax with food taxable is presented in Table 9. The greatest regressivity is shown in the Michigan study and the least is shown in the California study, although the Washington study and the Davies study of twenty-one large cities are very close to the California study. Inasmuch as the California sales tax—when food is included as was done in that study—is very similar to the Illinois sales tax, the figures for California are probably close to the situation in Illinois. If the figures for the 0-$2,000 and the over $10,000 income groups are omitted, the impact of the sales tax—as shown in the California study—is not far from proportional. There is good reason for eliminating the lower income group, because it includes many atypical people who temporarily have low incomes and whose expenditure patterns have not adjusted to their current income level. Then too, the lower income group includes many older people who are living off accumulated wealth, people who can afford to pay the tax but whose incomes are relatively low. This tends to distort low income tax burdens in relation to incomes and probably does not properly indicate the ability of these people to pay taxes.

Just what the regressivity of the sales tax means in terms of dollars of taxes paid can perhaps be best illustrated by comparing the sales tax with a proportional income tax as is done in Table 10. Under a sales tax with food included—in this case the California tax which is essentially similar to that in Illinois—the average person in the under $1000 category is pay-

TABLE 10

Actual Tax Displacement Resulting from Adoption of a Proportional Income Tax to Replace the Sales Tax

		Sales Tax, Food Included (3% Rate)			
Income Group	Average Base Income*	Tax as a Percent Of Income	Average Dollars Tax Paid	Average Dollars Tax Paid With a Proportional Income Tax (2.65%)	Actual Tax Displacement
Under $ 1,000	$ 814	4.01%	$ 33	$ 22	−$11
$1,000-$ 2,000	1,878	2.91	55	50	− 5
$2,000-$ 3,000	2,743	2.73	75	73	− 2
$3,000-$ 4,000	3.845	2.71	104	102	− 2
$4,000-$ 5,000	4,837	2.51	121	128	+ 7
$5,000-$ 6,000	5,822	2.71	158	154	− 4
$6,000-$ 7,500	6.932	2.85	198	184	− 14
$7,500-$10,000	8 863	2.43	211	230	+ 19
Over $10,000	15,103	2.09	316	400	+ 84

SOURCE: Columns 1-3 were taken from the *California Study*.
Columns 4-6 were calculated by myself.

*After federal income taxes.

†The 2.65% rate for the income tax was calculated to bring in approximately the same revenue as the 3% sales tax rate.

ing $11 a year more tax than he would with a proportional income tax. On the average, people in the other low income groups would save from $2 to $5 a year while the people in the higher income groups would pay from $19 to $84 a year more in taxes with the proportional income tax. While the regressivity of the sales tax seems highly significant at first glance, the actual dollars of tax displacement from one group to another by reason of its regressivity is not highly significant. This dollar amount becomes even less significant when the effect of the deductibility of state taxes against the federal income tax is taken into account.

Many methods have been proposed for improving the vertical equity of the sales tax, the most common of which is the exemption of food from the tax. Presumably, food expenditures bear relatively heavy on lower income groups and exemption of this important item would lower the tax burden of these people relatively more than it would lower the burden of people in high income groups. Table 11 shows the effect of the food exemption in California. While the food exemption does reduce the regressivity of the sales tax somewhat, the reduction is minimal.

Exemption of food from the sales tax base poses several problems. First, the tax rate must be higher to bring in the same revenue. The higher rate would result in greater problems with the border areas (to be discussed later) and with interstate competition in general. Second, state administration of the sales tax and compliance of retailers to the tax are made more difficult and hence more costly with a food exemption. In particular, checking out in grocery stores becomes more complicated because checkers must consider each item for its taxability. It is highly questionable whether the actual tax displacement in dollars resulting from food exemption, ranging from an $8 saving for the under $1,000 income group to a $44 increase in the over $10,000 income group, would improve the equity of the sales tax sufficiently to warrant acceptance of the problems that go with food exemption. The income tax might be used to replace the revenue lost from food exemption, in which case the tax displacement would be different from that shown in Table 11. However, unless the income tax were progressive, the difference would be very small. Adding a proportional income tax is little different from raising the rate of a sales tax which has a virtually proportional impact.

The Davies study also lends itself to a comparison of the sales tax with and without food exempt in terms of tax displacement. Again, the calculated tax displacement is small, ranging from a saving of $5 in the $2,000-$5,000 income groups to an increase of $44 in the highest income group. The calculations from the Davies study are not presented here because of their striking similarity to the calculations based upon the California Study.

One can seriously question the lengths to which any state should go in the matter of achieving vertical tax equity. The redistributive aspects of taxation are perhaps better handled at the federal level. Indeed, the

TABLE 11

Actual Tax Displacement Resulting from the Exemption of Food from the Sales Tax Base

		Sales Tax, Food Included (3% Rate)		Sales Tax, Food Excluded (3.9% Rate)†		
Income Group	Average Base Income*	Tax as a Perecent of Income	Average Dollars Tax Paid	Tax as a Perecent of Income	Average Dollars Tax Paid	Actual Tax Displacement
Under $ 1,000	$ 814	4.01%	$ 33	3.12%	$25	−$ 8
$1,000-$ 2,000	1.878	2.91	55	2.90	54	− 1
$2.000-$ 3,000	2,743	2.73	75	2.59	71	− 4
$3,000-$ 4,000	3,845	2.71	104	2.63	101	− 3
$4,000-$ 5,000	4,837	2.51	121	2.44	118	− 3
$5,000-$ 6,000	5,822	2.71	158	2.76	161	+ 3
$6,000-$ 7,500	6,932	2.85	198	2.96	205	+ 7
$7,500-$10.000	8,683	2.43	211	2.51	218	+ 7
Over $10,000	15,103	2.09	316	2.39	360	+ 44

SOURCE: Columns 1-3 were taken directly from the *California Study*. Column 5 was adapted from that source using a 3.9% rate. The remaining columns result from my own calculations.

*After federal income taxes.

†The 3.9% rate was calculated to bring the same revenue with food exempt as the 3% rate with food included.

highly progressive federal income tax has proved to be very effective at accomplishing a redistribution of income considered by many to be desirable. In the face of this very dominant federal tax, efforts of states to redistribute income by adopting progressive or proportional taxes as opposed to regressive taxes or by distorting the sales tax base to remove regressivity seem pitifully small.

This does not mean that states should deliberately adopt inequitable tax structures. It merely means that where a tax such as the sales tax is highly efficient in terms of administration and productivity, its slight regressivity should not be a bar to its use or a reason for its distortion into something less efficient and less productive. The sales tax is a good tax on many accounts, and the State of Illinois or any other state need not be apologetic for its slight regressivity. Nor should Illinois distort the tax by deliberate exemption of some items such as food from the tax in order to transfer a few dollars of tax from one income group to another.

Horizontal Equity

Not as much discussed but just as important as vertical equity are questions relating to the horizontal equity of the sales tax. In a recent study published in the *National Tax Journal,* Reed Hansen shows the sales tax to be "perverse," that is, the sales tax falls more heavily on large families than it does on small families within the same income group.[27] Table 12

[27] Reed R. Hansen, "An Empirical Analysis of the Retail Sales Tax with Policy Recommendations," *National Tax Journal,* March 1962. Hansen includes perversity in his discussion of vertical equity rather than horizontal equity.

TABLE 12

Effective Tax Rates Under the Typical Retail Sales Tax for Single Consumers and Families of Graduated Size and Income Living in Large Cities of the North
(In Percent)

Family Size	INCOME GROUP $1,000 to $2,000	$2,000 to $3,000	$3,000 to $4,000	$4,000 to $5,000	$5,000 to $6,000	$6,000 to $7,500	$7,500 to $10,000	$10,000 and Over
Single Consumer	1.31	1.13	0.95	1.03	0.92	1.00	1.24	0.60
Two person family	1.59	1.36	1.26	1.26	1.23	1.08	1.05	0.72
Three person family	1.96	1.64	1.42	1.37	1.28	1.18	1.13	0.87
Four person family	1.71	1.60	1.49	1.43	1.37	1.25	1.13	0.74
Five person family	2.25	1.73	1.59	1.56	1.51	1.32	1.16	0.98
Six or more family	1.88	1.84	1.64	1.58	1.60	1.28	1.28	1.09

SOURCE: Reed R. Hansen, "An Empirical Analysis of the Retail Sales Tax with Policy Recommendations," *National Tax Journal*, March 1962.

shows Hansen's calculations for a typical retail sales tax (food included, but few services) for families in large northern cities. The figures clearly indicate that the sales tax burden increases with family size in every income group. From these calculations Hansen concludes that the typical sales tax is inequitable on the score that it is perverse.

One could concede that large families pay more sales tax than small families without conceding that the sales tax is inequitable, however. A family of six has six people deriving benefits from public expenditures, while the single person is alone to claim such benefits. If the benefits received principle is not completely dead, then it is not inequitable for large families to pay slightly more tax than small families. Remember, the federal income tax has already taken the single person to the cleaners; he cannot split his income, nor can he claim more than one exemption. Perversity does not necessarily mean inequity; it might be completely consistent with a fair tax structure for larger families within a given income group to pay more taxes. In particular, the degree of perversity indicated in Hansen's study does not seem to be grossly inequitable.

Hansen goes on to demonstrate that exemption of food would virtually eliminate the perversity of the sales tax. This is largely due to the fact that single persons commonly eat restaurant meals which are taxable, whereas families carry tax exempt food home to eat.

It would seem from this latter aspect that a food exemption would increase the "capriciousness" of the sales tax. A tax is said to be capricious if it treats people differently on the basis of unreasonable differences. Is it not capricious to tax someone who must eat in restaurants and not tax someone who can carry his food home for wife or mother or cook? It is difficult to justify taxing people differently on the basis of their habit of eating at home or in public.

It seems from this standpoint that the most inequitable aspect of the typical sales tax is its capriciousness. Basically, capriciousness arises from the fact that the typical sales tax is not universal in coverage at the retail level. When some commodities and services are exempt from the sales tax, then people who happen to have a taste for these items pay less tax than people who prefer taxable goods and services.

Table 13 shows budgets for two families with the same income, $8,000, and the same amount of saving, $200. While these budgets are concocted extremes to show capriciousness in the Illinois sales tax, they do indicate the varying amounts of taxes that might be paid by similar families. Family No. 2 would pay sales taxes of $247, while family No. 1 would pay only $140 under the present Illinois sales tax. This results largely from the fact that family No. 1 likes plays, movies, and the resulting babysitters; the children get fancy private schools and dancing lessons; they keep an old auto repaired and travel little; they keep old clothes cleaned and use barbershops and beauticians instead of home care; and of course, their medical and legal fees are higher. Such expenditures largely avoid the sales tax.

On the other hand, family No. 2 keeps a relatively new car because they like to travel and camp out; they stay home in the evening and resort to the television, music, and reading; the children have more toys and athletic equipment, but no dancing lessons, and go to the public school across the street; they often cut hair at home and the wife uses home permanents. This spending pattern is hit heavily by the sales tax. Note that a food exemption would not improve the situation here, but would rather make it worse. This is where the Illinois sales tax is most inequitable; it is capricious.

Broadening the Sales Tax Base

The capriciousness of the Illinois sales tax could be significantly reduced if the tax base were broadened to include services. If all personal services including barbering, repairs, dry-cleaning, admissions, dancing schools, medical and legal advice, and private schools, were subject to the sales tax, the tax differential between the two sample families would diminish. Of course, there may be good reasons for not taxing medical and legal advice, and private schools; but dry-cleaning, barbering, admissions, repairs, and dancing schools could well be brought within the sales tax. Any broadening of the base would tend to make the sales tax less capricious.

Inclusion of services in the tax base would also tend to make the sales tax less regressive and less perverse. Hansen's study supports this conclusion.

TABLE 13

Sample Budgets for Two Families with Similar Incomes and Savings and the Resulting Sales Tax Paid

Item	Status*	Consumption Expenditure	
		Family No. 1	Family No. 2
Housing	P	$1,400	$1 450
Food and Drink	T	1,400	1,300
Tobacco	T	50	150
New Auto (annual ave.)	T	200	600
Auto repairs	N	300	50
Auto operation	T	180	400
Household operation	T	300	400
Clothes	T	200	800
Clothes cleaning	N	300	50
Beautician and barber	N	200	50
Personal articles	T	50	200
Radio, T.V., and Hi-Fi	T	20	200
Admissions	N	300	50
Babysitters	N	600	100
Other entertainment (books, etc.)	T	140	500
Dancing school	N	300	
Toys and athletic equipment	T	60	300
Medical care	N	600	500
Lawyer's fees	N	400	200
Education	N	600	
Miscellaneous	T	200	600
Savings	N	200	200
Total taxable expenditures		$3,500	$6.175
Total nontaxable expenditures		4,500	1,825
Sales tax paid (4% rate)		140	247

SOURCE: Based on my hypothetical figures.
*P—partially taxable; T—taxable; N—nontaxable.

This results from the fact that higher income families and smaller families spend relatively more on services than their counterparts. Thus it is clear that the overall equity, vertical as well as horizontal, of the sales tax would be improved if the tax base were made more universal by the inclusion of services. Furthermore inclusion of services would make the sales tax more productive and probably easier to administer in Illinois, contrary to exemption of food which would increase the difficulty of administration and reduce productivity.

Sales Tax Administration

The sales tax is generally thought to be easier to administer than the other major general tax at the state level, that is, the income tax. This results from the relatively small number of taxpayers under a sales tax and the relative ease of measuring the tax base.[28] In terms of cost, a relatively small percentage of the revenue collected by the states is eaten up in the cost of state administration and taxpayer compliance.

Administrative Costs in the Various States

It is difficult to compare the costs of sales tax administration in the various states because states have varying administrative organizations under which other taxes may be handled in the same department which administers the sales tax. Record keeping is often inadequate to properly allocate costs to the various taxes. Nonetheless, John Due has attempted such a comparison in his recent work on sales tax administration;[29] his results are shown in Table 14. The figures show a downward trend in administrative costs for most states, probably because of generally increased rates, fewer vendors relative to revenues, and from longer experience with sales tax administration.

The figure of .87% for Illinois is probably understated. More recent figures indicate that the percentage cost for 1960 was 1.17% based upon revenues of $374 million and estimated administrative costs of $4,386,788. This cost figure for Illinois includes the cost incurred by the state in administering the municipal sales tax increment. How much lower costs would have been in the absence of the municipal tax is hard to say because of the difficulty of allocating such costs; however, the reduction would probably be in order of 10% of the total administrative costs making the percentage cost of collection of the state sales tax about 1.05%.

Illinois' administrative costs are relatively lower than the costs in most other states. However, it is possible that the state is being penny-wise and pound-foolish in this regard. California, which is commonly regarded to have a model administrative organization, has a relatively high cost of administration, largely because it has an all-out enforcement program. If Illinois were to substantially increase its enforcement program, the percentage cost of administration would rise, but overall efficiency would probably improve.

The Audit Program

California has about 800 auditors to cover 327,000 vendor accounts, or about one auditor for each 400 accounts. Illinois, on the other hand, has about 130 auditors to cover 142,000 accounts, or about one auditor for each 1,100 accounts. These figures, combined with the fact that the average account is larger in Illinois, indicate that Illinois has an enforcement program only about one-third as extensive as that in California. The number

[28] John F. Due, *Sales Taxation* (Urbana: University of Illinois Press, 1957), p. 34.
[29] John F. Due, *Sales Tax Administration*.

TABLE 14

Sales Tax Collection Costs Expressed as a Percentage of Sales Tax Revenue

State	1959-60	1959-60 Per 1% of Tax Rate	1940	1948	1955
Illinois	.87	.29	2.0	2.0	1.5
Michigan	.8	.27	1.7	1.0	.9
Ohio	1.2	.40	1.9	1.1	3.8
Iowa	.9	.49		1.1	
Missouri	1.6	.80	2.0	1.0	
Kansas	1.4	.36	2.5		
North Dakota	.63	.31			1.3
South Dakota	.98	.49		1.5	
Tennessee	.67	.22		1.1	
Kentucky	1.3	.44			
Colorado	1.6	.80	6.0	1.4	1.4
Utah	1.0	.50	2.2	.9	
Wyoming	1.0	.50	3.1	1.5	
Arizona			4.0	1.3	
New Mexico				1.9	
Nevada	1.4	.70			
California	1.7	.59	2.6	1.9	2.0
Washington	.8	.20		.7	
Arkansas			3.0	2.0	
Oklahoma	1.4	.70	.9		
Louisiana					
Mississippi	1.03	.34	3.6	1.6	
Alabama	1.6	.55	4.5	2.2	1.7
Florida	1.1	.37			1.9
Georgia	1.1	.37			
South Carolina				1.2	1.6
North Carolina	1.36	.45		.7	1.6
Maine	1.5	.50			
Rhode Island					
Connecticut					
Pennsylvania	1.8	.45			
Maryland	1.15	.38			
West Virginia	.79	.26		1.0	

SOURCE: John F. Due, *Sales Tax Administration*. Due obtained the data for 1940, 1948, and 1955 from J. H. Maloon and C. V. Oster, "Sales Tax Administration Costs," *National Tax Journal*, September 1957, pp. 228-35.

of accounts per auditor for the other sales tax states is shown in Table 15. Again, these figures are not completely comparable because of the different

TABLE 15

Number of Vendor Accounts Per Auditor in the Various Sales Tax States in 1960

State	Accounts Per Auditor	State	Accounts Per Auditor
New Mexico	297	Colorado	1,100
California	396	Pennsylvania	1,135
Michigan	421	Illinois	1,152
Alabama	529	Connecticut	1,200
Maryland	597	Arizona	1,283
Utah	600	Nevada	1,286
Maine	714	Tennessee	1,463
Kentucky	778	North Carolina	1,542
Washington	881	Oklahoma	1,640
Mississippi	892	Rhode Island	1,692
Iowa	918	Florida	1,850
Missouri	937	North Dakota	2,125
Georgia	965	Kansas	3,571
Louisiana	1,021	South Dakota	4.000
South Carolina	1,021	Wyoming	10,000
Arkansas	1,025	West Virginia	12,770

SOURCE: John F. Due, *Sales Tax Administration.*

organizations in the various states. For example, in Florida and Louisiana substantial auditing is done by so-called field men who do not show up as part of the audit staff.[30]

If the Illinois Legislature appropriated added funds for enlarging the sales tax audit program the result would be to increase state revenues from two sources: (1) larger claims against vendors who report their tax incorrectly; and (2) improved self-assessment resulting from better information and the vendors' knowledge that they are more apt to be audited. Presumably, there is some optimum audit program; but, while it is clear that Illinois is well below the optimum, it is not easy to determine how far the state has to go. The state could provide for a 100% audit program—each firm audited once during each three-year reporting period—but such a program would undoubtedly be inefficient in that the revenues realized from the last audits would not compensate for their cost.

California has provided the most thorough study of the sales tax audit program.[31] One of the conclusions of that study is that an optimum program would be one in which the added revenue resulting from claims and improved self-assessment plus overreported tax refunded minus audit costs

[30] See John F. Due, *Sales Tax Administration* for a more detailed description of the audit program in the various states.

[31] Ronald B. Welch, *The California Sales Tax Sample Audit Program* (Sacramento: California State Board of Equalization, 1954).

would be maximized. In other words, under an optimum program the audit staff would be increased until the last auditor no longer pays for himself in increased revenue for the state and refunds to overreporting taxpayers. One could argue that only added revenues collected by the state should count; in other words, the taxpayer should look after himself rather than depend upon the state auditors to turn up overpayment of taxes. With respect to Illinois, this question is currently mute since the audit program is far under the optimum.

The California audit study found that the audit program in California was only slightly less than optimal; about a 15% increase in audit work would have resulted in an optimal program at that time. If conditions in Illinois can be assumed to be similar to those in California, this suggests that the Illinois audit program would have to be increased about threefold to approach the optimum.

The Illinois audit program is organized into two distinct sections. In Chicago the audit program is run from the Chicago office of the Department of Revenue. In all other areas of the state—so-called downstate—the program is run by the Springfield office. The downstate area is further subdivided into seven districts each headed by a supervising auditor. Table 16 presents the audit results in the two major divisions for the fiscal years 1960, 1961, and 1962.

The better performance shown in Chicago can probably be explained in part by their tight geographical area and hence less travel and easier accessability to records. Then too, that office has apparently been subject to less personnel turnover and consequently probably has a generally more qualified audit staff. Also mitigating the performance differential between the Chicago and downstate offices is the better collection record in the downstate offices. Chicago turns up more deficiencies, but a larger percent of these go uncollected. This situation might indicate a slight ballooning of claims in Chicago with consequently greater resistance on the part of the audited taxpayer.

For the 1960-62 period the 5,864 audits in Chicago and the 2,930 audits downstate represent approximately 8% and 3% of the accounts in each area respectively. Although many other accounts are surveyed informally through an estimation process based on income tax records and records of suppliers—this is apparently done to a greater extent in Chicago—these figures indicate a woefully small audit coverage. Since many of these audits cover purely use tax accounts, currently the most profitable source of audit, the percentage of strictly ROT accounts audited downstate in any three-year period is almost infinitesimal, perhaps less than 2%. This infrequency of audit means that many deficiencies go undiscovered, and furthermore, that taxpayers are encouraged to undereport taxes in the belief that there is little chance that they will be audited. This is particularly true of small accounts which are commonly by-passed altogether.

TABLE 16

Audit Results in Illinois For Fiscal Years 1960, 1961, and 1962

Area	Number of Audits Discovering No Deficiency	Audits Discovering Deficiency		Total Number Of Audits*	Average Number Of Auditors	Average Number of Audits Per Auditor	Average Deficiency Discovered Per Auditor
		Number	Amount of Deficiency				
Fiscal year 1962							
Chicago	786	1,003	$ 3,361,859	1,878	72	26.1	$ 46,692
Downstate	506	621	1,667,373	1,201	76	15.8	21,939
Fiscal year 1961							
Chicago	1,021	994	$ 4,757,296	2,105	69	30.5	$ 68,946
Downstate	224	548	2,918,102	858	57	15.1	51,195
Fiscal year 1960							
Chicago	875	885	$ 4,411,938	1,881	70	26.9	$ 63,027
Downstate	377	414	2,881,738	871	62	14.0	46,480
Three Fiscal years 1960-62							
Chicago	2,682	2,882	$12,531,083	5,864	70	83.8	$179,015
Downstate	1,107	1,583	7,467,231	2,930	65	45.1	114,880

SOURCE: Illinois Department of Revenue (unpublished data).
*Includes audits of accounts which turned up overpayment of sales tax.

While the Department of Revenue could improve its internal efficiency --and the staff is well aware of this—the major reason for the inadequacies in the audit program is insufficient appropriations for administration of the sales tax. A substantial increase in the appropriations for audit purposes would facilitate a much broader coverage of ROT and use tax accounts and would greatly improve sales tax equity as among reporting retailers. Even though such a program would significantly increase state administrative costs, it would pay for itself several times over through increased revenues from improved reporting and deficiencies discovered in audit.

While a greater study of the audit program in Illinois would be needed to pinpoint with accuracy the increases in revenues which could be expected from increased appropriations, some general considerations and rough estimates can be noted. In 1960 the average administrative cost per auditor was about $10,000; this included the auditor's salary plus accounting, communications, and legal expenses, among others, which accompany an auditor's work. This figure would probably increase from three to five percent a year if comparable audit personnel were to be maintained on the staff. Thus the cost per auditor would have been about $11,000 in 1962 and would be about $12,000 in 1964. During the 1960-62 period, during which the annual cost per auditor was about $10,500 or about $31,500 for the three years, the typical Illinois auditor, Chicago and downstate combined, turned up $140,000 in deficiencies. While only an approximate 75% of these deficiencies were collected by the state—figures are not available to show precisely how much was collected—this means that a typical auditor who cost about $31,500 added about $105,000 in revenues to the state. These figures do not account for an undetermined amount of revenue resulting from better tax reporting which would have not occurred had the auditors not been at work.

If the audit staff were augmented with comparable personnel, the average cost per auditor would probably increase because of the need for paying higher salaries to attract the additional people. Also, the amount of deficiency discovered per auditor would probably decline since less profitable accounts would be audited. In particular, virtually all of the new audits would be on retailers paying ROT since large use taxpayers are well audited under the current program. Nevertheless, it is clear that, for a while at least, added appropriations for audit would more than pay for themselves in deficiencies discovered and collected and in improved self-assessment by taxpayers. Extrapolating from the California experience, it would be profitable to increase the Illinois audit program about threefold. This would entail an additional cost of approximately $3,500,000 a year by 1964, but it could be expected to increase state revenues by about $7,000,000 that year making a net gain to the state general fund of about $3,500,000.

Not only would general revenues be augmented by increased appropriations for enforcement of the sales and use taxes, the impact equity, that is,

equity as between retailers who correctly or incorrectly report the tax, would be substantially improved.

Other Aspects of Administration

Other aspects of sales tax administration are of course worthy of concern; however, the scope of this report does not permit a detailed investigation of them. Moreover, most of these matters are of internal concern to the Department of Revenue, although the legislature is naturally concerned with the overall performance of that department. To the Department of Revenue and to interested legislators, I recommend a careful scrutiny of the extensive work on sales tax administration recently completed by Professor Due.[32] In this work he has compiled a vast amount of facts about administrative procedures in sales tax states, and he offers a running commentary on the merits of various procedures in such administrative areas as field and office auditing, delinquency, personnel, departmental organization, registration and returns, and machine accounting.

Compliance Costs and the Vendor Discount

Retailers incur costs in complying with the sales tax. Because retailers are primarily thought of as tax collectors rather than taxpayers, some states allow retailers a discount—ranging from 5% of taxes paid in Colorado to 2% in eight states which include Illinois and Ohio—to cover the cost of compliance with the sales tax.

A number of estimates of compliance costs have been made yielding answers of 20.6% of taxes paid for grocery stores in one study to 1.1% for department stores in another study.[33] (The estimated 20.6% compliance costs for grocery stores occurred in Ohio which exempts food; this is further indication that a food exemption is costly in terms of administration and compliance.) While it is difficult to say with precision what compliance costs are in a particular case, one thing is very clear: such costs in any state vary widely among retailers with average prices of goods sold—car dealers have lower compliance costs than do variety stores—and with the difficulty of selling both taxable and exempt goods. Under these circumstances, a flat rate discount is less than worthless because it fails to distinguish between retailers in accordance with compliance costs incurred, and actually subsidizes the low cost collector at the expense of the high cost collector. South Carolina and Alabama have graduated their vendor discount in accordance with the amount of tax paid, but this does little to correct the basic difficulty.

In Illinois with its 2% vendors' discount, the sales tax rate is in effect 98% of 3.5% of sales, or actually 3.43% of sales. However, retailers are allowed to shift on the basis of a 3.50% tax, and the difference between the 3.43% paid and the 3.50% collected makes up the vendors' discount. If retailers paid 3.50% to the state instead of 3.43% the discount lost would

[32] John F. Due, *Sales Tax Administration.*

[33] Tax Foundation, Inc., *Retail Sales and Individual Income Taxes in State Tax Structures* (New York: Tax Foundation, 1961), p. 37.

merely be an added expense of doing business and presumably would show up in the price pattern and be shifted to consumers by reason of competition. Thus, the vendors' discount is in the main a fiction which fails to do what it should do, distinguish between retailers in accordance with compliance difficulty, and hence should be dispensed with. Compliance with tax laws is not compensated under other taxes and need not be done under the sales tax. Doing away with the 2% vendors' discount would increase state revenues by an approximate $10 million in the fiscal year which ends June 30, 1964.

The Sales Tax and the Economic Climate

The sales tax has rarely been on trial for its adverse effects on the state of business. It has no high marginal rates to dampen incentives to produce, nor does it impose upon the successful business concern and induce it to locate in another community. Businessmen quite agree that the sales tax is preferable to the income tax, or for that matter most other taxes, from the standpoint of promoting a healthy business climate. However, certain aspects of the sales tax must come under scrutiny.

The Border Problem

One aspect of the sales tax that has long caused concern is its impact on retailing along state borders. If a family living in Rock Island can purchase appliances in Davenport and have them delivered across the border free of both the Iowa and Illinois sales taxes, one can expect some leakage of business from Illinois to Iowa. This aspect results from the interstate commerce clause of the United States Constitution which, as interpreted, prevents states from applying the sales tax on goods to be delivered out of the state to out-of-state residents. This factor has led, as previously discussed, to widespread adoption of the use tax which makes such goods fully taxable to the purchaser at the same rate as if he had bought the goods at home. On most items, however, the use tax is difficult to enforce—cars are a notable exception—and the result is that interstate leakage continues. Of course, Davenport residents have the same incentive to purchase in Illinois for home delivery, thus avoiding both sales taxes; as a result, the leakage might go both ways.

The basic problem on the border between sales tax states is with home delivery, because goods delivered at the store are fully taxable regardless of the residence of the purchaser. Only when there is a substantial difference between the tax rates of the bordering states, or when a prominent metropolitan and consequent "good shopping" area lies across the border as in the case of St. Louis, does store delivery pose a problem. On the Indiana and Wisconsin borders, however, store delivery might pose a significant problem since Indiana does not have a sales tax as such and Wisconsin—under its new sales tax—has a wide variety of exemptions from the tax.

The significance of business leakage across state borders is difficult to assess; however, Table 17 which shows 1958 tax collections in Illinois border

counties as compared with interior counties might shed some light on the matter. The reason more recent figures than 1958 were not used was to permit use of data on county personal income, an important variable in determining tax collections. Cook County and suburban counties were not included because of the difficulty of accounting for the diverse factors would show up in such an area.

Bearing in mind that higher per capita income should mean a lower rate of tax to income because of sales tax regressivity—other factors equal—a few tentative conclusions can be drawn from the figures in Table 17.

TABLE 17

Tax Collections Compared With Income for Illinois Border and Interior Counties in 1958

	Counties	Number of Counties	Total Sales Taxes Collected (Thousands)	Total Personal Income (Millions)	Per Capita Income	Sales Taxes As a Percent Of Income
All interior counties . . .		56	$58,437	$3,898.8	$1,906	1.51%
Iowa	Bordering Davenport	3	$ 6,104	$ 482.4	$2,264	1.27%
Iowa	Other counties . . .	6	4,043	273.3	1,775	1.48
Iowa	All counties bordering Iowa . .	9	$10,147	$ 755.7	$2,059	1.34%
Missouri	Bordering St. Louis	5	$12,264	$ 972.3	$1,910	1.26%
Missouri	Other counties . .	7	5,093	327.4	1,552	1.56
Missouri	All counties bordering Missouri	12	$17,357	$1,299.6	$1,805	1.34%
Indiana	Bordering Terre Haute	2	$ 936	$ 63.6	$1,590	1.47%
Indiana	Other counties . . .	8	8,170	523.7	1,757	1.56
Indiana	All counties bordering Indiana	10	$ 9,106	$ 587.3	$1,738	1.55%
All counties bordering Wisconsin . .		4	$10,630	$ 750.7	$2,296	1.42%
All counties bordering Kentucky . .		5	$ 678	$ 50.2	$1,141	1.35%
All border counties . . .		40	$47,918	$3,443.5	$1,917	1.39%

SOURCE: Tax collections were taken from the *Fifteenth Annual Report of the Department of Revenue of the State of Illinois.* Income figures were taken from Scott Keyes, *Personal Income in Illinois* (Urbana: Bureau of Community Planning).

(1) There was indeed some leakage of retail trade across the Illinois border in 1958 as indicated by the ratio of taxes to income of 1.39% for border counties as compared with the ratio of 1.51% for interior counties, per capita income being about the same in both cases.

(2) With exception of the unusual Kentucky situation, the leakage was greatest in the St. Louis area as shown by the low ratio of taxes to income (1.27%) and average per capita income in those counties. This was to be expected in view of the "good shopping" opportunities across the river.

(3) Leakage to Wisconsin was nil, probably because of the lack of a large Wisconsin shopping center close across the line from a populous Illinois area.

(4) Leakage to Kentucky was unusually high, especially in view of the relatively little access to a large shopping center in that state. One would be inclined to think Massac county did all its shopping in Paducah, except for the fact that county's ratio was 1.64%, much higher than in the other four counties bordering Kentucky.

(5) Metropolitan areas across the border generally mean a greater leakage of retail trade out of the state.

The big problem with border areas is not the tax structure itself, but rather the difficulty of enforcing the use tax. When one deals with thousands of individuals and their myriad of purchases, there is no easy way, short of strong armed entry and search, to get them to report out-of-state purchases and pay the use tax. Improvement in this area must come from collection of the use tax from the seller rather than the purchaser, and as previously noted, recent court decisions and actions by the Department of Revenue show a hopeful trend. One disturbing aspect must be noted: the United States Congress has been holding hearings on a bill which would seriously limit state powers to collect use taxes at the source, but this bill is still in committee and its disposition cannot as yet be stated with certainty.

For now, the current program of registering out-of-state retailers to collect the Illinois use tax should improve the border situation. While this solution does not get at the Illinois resident who shops in another state and takes delivery there, thus paying the other states sales tax (if any), it does get at the more pressing problem of goods purchased for delivery in Illinois. Hopefully, a successful prosecution of this program will forestall willful out-of-state shopping to the detriment of Illinois retailers, and if not, at least collect taxes for the Illinois purse. A measuring of the results must await more recent figures on income and tax collections in border counties.

The Sales Tax as a Tax on Business

While the retail sales tax is normally thought to be a tax on consumers, it may rest in part on business, depending upon the structure of the tax. In Illinois all goods purchased by business concerns except for goods and ingredients of goods for resale, are subject to the sales tax. In industries where

capital costs are high in relation to materials and labor costs—public utilities for example—this tax can amount to a substantial burden. (Currently, many firms avoid the tax because their equipment is custom made.) How much of the tax on business equipment is shifted to consumers and how much is borne by business is difficult to say; this depends upon the state of competition and the tax structure in competing states, among other things.

Businessmen might argue that the sales tax as applied to equipment purchases reduces their ability to compete with business in other states, Ohio and Michigan, for example, where much of this equipment is exempt because of the direct-use rule. Because of the competition with firms in other states, much of the tax on equipment is not shiftable. To the extent that this aspect of the sales tax is significant it might encourage firms to locate in other states to avoid the tax on equipment.

However, the sales tax cannot be considered in a vacuum. Taking a peek outside the bounds of the sales tax, one notes that taxes on business are generally low in Illinois.[34] Illinois has no corporation income tax, virtually no state property tax, and only a nominal franchise tax based on capital stock and paid-in surplus, while states housing competitors for Illinois businesses, Michigan and Ohio in particular, have significant business taxes. Although it is true that Illinois firms bear a sales tax burden on equipment purchases, it is equally true that they do not bear much of a burden from any other state tax.

The sales tax as applied to equipment does have a varying impact on businesses depending on the relationship between capital and other costs, and this aspect of the tax is not desirable. However, since most firms in close competition have similar cost structures, any adverse effects of the sales tax on competition are probably not very significant.

From the standpoint of designing a genuine single-stage sales tax, it would be desirable to exempt most business purchases from the tax; however, this would free from taxation one part of the Illinois community, namely business, which already has a relatively light tax burden. In this light, exemption of business purchases should not be considered at this time. Moreover, an attempt should be made to make the tax on business purchases more universal by doing away with the custom-made exemption which so many firms hide behind. One way of doing this would be the adoption of a general sales tax on consumer and business services.

PRODUCTIVITY OF THE SALES TAX

Over the past three decades in Illinois the sales tax has produced more tax revenue at the state level than any other single tax, and it is likely to continue its dominance in the years immediately ahead. In fiscal 1962 the sales tax—ROT, SOT, Use Tax, Service Use Tax, and Hotel Tax—produced almost $500 million; if the tax on public utility services is included,

[34] John F. Due, "Taxation, Industrial Location and Tax Reform," *Illinois Business Review*, March 1961. With respect to taxes on business, Due says that Illinois currently has a "good image."

as it might well be, total production was about $555 million. This figure is well over 50% of all tax revenue collected by the state.

With respect to sales tax productivity, however, several questions might be asked: (1) how stable is it? (2) how much more can be raised through rate increases? (3) how would exemptions from the tax base or broadening of the base affect its productivity?

Stability of Sales Tax Revenue

Fluctuations in economic activity can be expected to produce instability in the yield of the sales tax. Since states do not have unlimited borrowing powers nor monetary powers, instability is undesirable because it makes for difficulty in the planning of state expenditures. The sales tax, however, is superior to the income tax in this respect since consumption expenditures, the major part of the sales tax base, fluctuate less over hill and dale of the business cycle than do taxpayers' incomes, the base of the income tax.

A review of sales tax productivity in Illinois shows remarkable stability. Table 18 shows annual sales tax yields per 1% of tax rate for the last twenty years in Illinois. The rate adjustment was made to remove the illusory effect of rate changes. (Ideally, a stability study should remove the effects of changes in the tax base, but that would require an effort not warranted here). As might have been expected, revenues increased markedly during and after World War II because of rapidly rising incomes, but since 1948 the sales tax yield has shown slow but steady increases with a maximum deviation from the trend of less than three percent, even though the economy passed through four recessions during that period.

In a study of sales taxes David Davies found that of the four major sales tax states—Illinois, Ohio, California, and Michigan—Illinois has had

TABLE 18

Sales Tax Yields in Illinois Per One Percent Of Tax Rate, 1943-1962
(In Millions of Dollars)

Year	Yield	Year	Yield
1943	$ 42.8	1953	$106.8
1944	46.6	1954	102.0
1945	49.1	1955	104.2
1946	65.9	1956	113.1
1947	78.9	1957	117.3
1948	87.8	1958	122.8
1949	85.5	1959	121.9
1950	92.1	1960	129.1
1951	98.0	1961	126.3
1952	100.7	1962	142.9

SOURCE: *Annual Reports of the Department of Revenue.*

the most stable sales tax yield.[35] One of the reasons for this stability is undoubtedly the broad legal base of the Illinois sales tax. While Illinois does have its major exemptions—custom made machinery for one—which significantly reduce the yield of the tax, taxes on these items would be rather more unstable than taxes collected on the non-exempt base. With respect to Michigan and Ohio, Illinois has also benefited from a relatively more stable economy.

Broadening the sales tax to include services would generally contribute to the sales tax stability, while exemption of food would undoubtedly reduce stability. Since California has an otherwise broad tax base with respect to tangible commodities, it is likely that its food exemption accounts primarily for its instability of sales tax yield. The adverse effect upon stability of revenue is thus a further argument against food exemption.

Revenue from Rate Increases

Ostensibly, there is no limit, short of complete confiscation of taxpayers' income, on the revenue that the sales tax might produce. One can imagine sales tax rates of 20 to 25%, and while that does not seem likely, remember that income tax rates of 90% did not seem likely 50 years ago. If taxpayers thought the high rate was short lived, they could avoid the tax partially by postponing consumption; but if the high rate were considered permanent, nothing could be gained from postponement of consumption spending. The point here is not that a 20% tax rate is likely or desirable, but rather, if the time should come when people demand so many public services as to require such a tax rate there is no *a priori* reason why it could not exist and produce the desired revenue.

Probably the limiting factor on increasing the sales tax rate is the situation in other states, particularly those on the border. Increasing the tax rate would aggravate the border problem which presumably could become intolerable if the Illinois rate were way out of line with the bordering states. Thus, if surrounding states resort to other than the sales tax for their increased revenue needs, Illinois will be limited in its ability to raise the sales tax rate. On the other hand, if surrounding states raise sales tax rates for the needed revenue, Illinois will be free to do so. A limit of this type does not seem imminent, however, and it is my opinion that tax rates of 4%, or even 5% are not inconsistent with maintenance of an orderly border situation.

With respect to revenue produced, a 4% tax rate for 1964 could be expected to produce approximately $73 million more than would be produced with the current tax base and 3.5% rate. A rate of 4.5% would produce about $144 million more. If, of course, the tax base were broadened to include services, the rate increases would yield even more revenue.

---

[35] David G. Davies, "Sales Tax and the Stable Growth of Income." *National Tax Association Proceedings*, 1960, p. 533.

Changes in the Sales Tax Base

If the sales tax were broadened to include transactions not now covered, the state could realize a substantial revenue increment without having to raise the tax rate. On the other hand, if the legislators were to narrow the base, say by food exemption, the tax rate would have to be raised to maintain the current level of productivity.

A tax on services. Personal and business services provide the most fruitful area for expansion of the sales tax base. The following figures are estimates of the *annual* revenue increments that would result from such an expansion of the tax base in the fiscal year 1964 if the 3.5% rate were maintained:

Service	Annual Tax Increment (millions of dollars)
PERSONAL:	
Laundries	$ 9.0
Beauty and barber shops	5.4
Shoe repair	.5
Funeral services	2.0
General garment repair and storage	1.0
Auto repair	7.9
Auto parking	1.1
Electric repair	3.5
Watch and jewelry repair	.3
Reupholstery	.5
Miscellaneous repair	2.5
Motion pictures	1.6
Other amusements	5.9
Photo studios	1.6
Miscellaneous personal services	.7
Total personal services	$43.4
PROFESSIONAL:	
Physicians	$17.0
Hospitals	19.9
Dentists	5.5
Other medical services	2.5
Opthamolic and orthopedic	3.7
Brokerage and investment counseling	4.1
Bank service charges	2.6
Legal services	5.2
Total professional services	$0.5
Business services including advertising, printing, etc.	$60.0
Taxes now lost because equipment has been declared custom-made and hence primarily a service	$60.0

These estimates are based primarily upon data taken from the 1954 and 1958 *Census of Business* and the *Survey of Current Business.* Other State of Illinois and federal government data formed the basis for the necessary adjustments.

The figures shown are probably optimistic in that no allowance was made for services which would be sold to out-of-state patrons, and would hence be nontaxable. This could be offset, at least in part, by a service use tax which would collect taxes on services imported from other states, but such a tax might be difficult to enforce. Also, no allowance has been made for evasion and sales to nontaxable customers; all such allowances would be tentative at best. However, if a margin of safety is desired, a 10% reduction in the estimates should bring them down to a more practical level.

Optimistically, the total yield of a tax covering the services outlined would be about $223 million in the fiscal year 1964 or about $456 million in the 1964-65 biennuim. If the $530 million that the present sales tax structure can be expected to produce at a 3.5% rate in the fiscal year 1964 were enough revenue to carry on the desired state activities, inclusion of services in the tax base would permit the tax rate to be lowered to about 2.5%.

A service tax might include only some of the services previously enumerated. For instance, the service tax might include only personal and professional services in which case the added yield would be $104 million at a rate of 3.5%. With the addition of this service tax a rate of 3% would be required to produce more than the $530 million expected with the present base and 3.5% rate. Numerous variations of this theme are possible, and Table 19 shows estimates of the revenue that would be yielded in the fiscal year 1964 and the 1964-65 biennium with various tax bases and rates.

Food exemption. Food for home consumption forms a large part of the sales tax base in Illinois. If such food were to be exempt from the sales tax in the fiscal year 1964, an estimated $87 million in tax revenue would be lost to the state under the current 3.5% rate. This estimate was constructed from a comparison of taxes collected from food stores in California where take-home food is exempt and Illinois figures for 1961. In terms of tax rates, if food were exempt from the tax base, a rate of 4.2% would be needed in 1964 to produce about the same revenue that can currently be expected with a 3.5% rate and food taxable.

SUMMARY AND RECOMMENDATIONS

The sales tax, now used in thirty-seven states, is the largest single producer of revenue at the state level of government. Thirty states, including Illinois which currently derives over 50% of its tax revenue from the sales tax, rely more heavily on the sales tax than any other form of taxation.

The breadth of the sales tax base varies widely among the states, ranging from sales of tangible personal property with numerous exemptions in some states to all transactions in commodities and services in other states.

TABLE 19

Estimated Sales Tax Revenue in the Fiscal Year 1964 (1964-65 Biennium) With Various Tax Bases and Rates
(In Millions of Dollars)

Tax Base	Tax Rate 2.5%	3.0%	3.5%	4.0%
Present tax base (including the ROT, SOT, use taxes, and the hotel tax)	$ 381 (777)	$ 456 (930)	$ 530 (1,079)	$ 603 (1,228)
Present tax base plus personal services	413 (839)	493 (1,001)	573 (1,164)	652 (1,324)
Present tax base plus personal and professional services	457 (928)	546 (1,109)	634 (1,287)	721 (1,464)
Present tax base plus personal and professional services and custom-made equipment	501 (1,018)	598 (1,215)	694 (1,410)	789 (1,602)
Present tax base plus personal and professional services and custom-made equipment and other business services	542 (1,101)	648 (1,316)	753 (1,529)	857 (1,741)

SOURCE: From my estimates of revenue increments due to expansion of the base and rate adjustments.

Illinois has a relatively broad legal coverage of tangible personal property, but prior to this year court interpretations had exempted important categories of sales from the ROT giving Illinois effectively a narrow sales tax base. The General Assembly broadened the ROT and passed the SOT in 1961 which, together with recent court decisions, have broadened the tax base somewhat as applied to tangible personal property. However, beyond special taxes on public utility services and transient room rentals, Illinois does not apply the sales tax to services.

All sales tax states have a supplementary use tax to mitigate the effect of interstate commerce on the yield and equity of the sales tax. In Illinois the Department of Revenue is working for more effective enforcement of the use tax through voluntary registration of out-of-state sellers as use tax collectors. To date the program has been somewhat successful, although greater success could be expected if neighboring states would join in a reciprocal agreement for mandatory collection of the use tax.

By most criteria the sales tax is a good tax. It is highly productive as can be seen from data on state revenues. The sales tax is administratively efficient as shown by the relatively low costs of compliance and administration. The sales tax is generally thought to be conducive to a healthy economic climate, and to the extent that it is universal in coverage, offers little barrier to a free allocation of resources in line with consumer wants. Only on equity grounds does the sales tax come under serious fire from tax critics.

The Illinois sales tax is somewhat regressive, although broadening of the base to include services or exemption of food would reduce its regressivity. The sales tax is perverse, but it is not clear that some perversity is undesirable. The Illinois sales tax is also capricious in that it taxes those people who spend for commodities and exempts those who spend for services. Both perversity and capriciousness would be significantly reduced if the sales tax were broadened to include services, but exemption of food from the tax would reduce perversity only at the cost of increasing its capriciousness.

So far as productivity is concerned, the sales tax is capable of producing the revenue needs of the state in the near future, either by rate increases or broadening of the base. As for the long run needs of the state, great increases in revenue might require a new tax, but only to the extent that bordering states turn to another tax, in particular the income tax.

Recommendations

On the basis of this study, I recommend the following measures:

1. The sales tax base should be broadened to cover the business of selling services at retail as well as tangible personal property. Such a broadening of the base would be best accomplished with a general sales tax on services which would cover all personal, professional, and business services. Such a statute would have the added attraction of bringing commodities now exempt on custom-made grounds under the sales tax. This program would also enable the present SOT and utility and hotel taxes to be abolished with the consequent reduction in tax complexity.

2. In the event a general service tax cannot be passed, then a series of special statutes should be enacted to bring all personal and selected business and professional services under the sales tax. Any broadening of the sales tax base would improve its equity and productivity.

3. Future revenue needs of the state would be best met by broadening the base of the sales tax rather than by adoption of a proportional income tax. Broadening the sales tax base to include services would reduce regressivity of the state tax structure just as would adoption of a proportional income tax (of course, a progressive income tax would accomplish more in the way of income redistribution); moreover, continued reliance on the sales tax alone would make for a less expensive and less complicated tax structure.

4. In the event the income tax, or any other tax for that matter, were adopted to supplement the sales tax, the sales tax base should still be broadened to include services and the amount of revenue from the sales tax held

in line through rate reductions. The equity of the sales tax would be improved by expansion of the base; therefore, such expansion should be accomplished whether or not added revenue is needed from the sales tax.

5. Food should not be exempted from the sales tax. Such an exemption would substantially increase enforcement and compliance difficulties as well as increase capriciousness of the tax. Reduction in regressivity would be better accomplished through broadening of the base, or even by adoption of an income tax.

6. The General Assembly should substantially increase appropriations for enforcement of the sales tax. Increased appropriations would permit a larger audit staff which would more than pay for itself in increased revenues through discovery of tax deficiencies and improved self-assessment. Also, better enforcement would improve the impact equity of the sales tax.

7. The State of Illinois should continue to work for reciprocal agreements with bordering states for mandatory registration and collection of the use tax by sellers.

8. The vendors' discount should be eliminated from the sales tax.

CHAPTER XXI

TOBACCO, ALCOHOLIC BEVERAGES, AND PARI-MUTUEL TAXES

By Karl B. Marx*

Introduction

This chapter was written to provide a basis upon which the General Assembly could make decisions as to whether specific excise tax rates levied on tobacco products, alcoholic beverages, and horse racing should be increased at this time. Therefore, the approach has been one of an economic analysis of the major sources of state revenue from these products, rather than a detailed description of each aspect of each source of revenue as was well done by Dr. J. D. Morgan in the 1949 *Report of the Revenue Laws Commission of the State of Illinois.*

An attempt has been made to estimate the additional revenue that would result if tax rates are increased. In addition, recommendations have been made as to whether specific excise tax rates should be increased. It is inevitable that the value judgments of the writer have influenced his rcommendations. However, it is hoped that these value judgments reflect the value judgments of the majority of the electorate.

THE TAXATION OF TOBACCO PRODUCTS

Cigarette Taxes

Forty-seven states currently levy excise taxes upon cigarettes sold within their respective borders. An excise tax of two cents per package of twenty cigarettes was adopted in Illinois in 1941. However, the rate was increased to three cents per package in 1946 to finance World War II veterans' bonuses. The rate was again increased by one cent per package August 1, 1959, to pay a bonus of $10,500,000 to Korean War combat veterans. By June 7, 1960, less than one year later, the money deposited in the Korean Bonus Fund had reached the required $10,500,000 level, and the cigarette tax rate was reduced to three cents per package.[1] The tax rate was again increased to four cents per package May 1, 1961, and has remained at that level to the present date (September, 1962).

Comparison of Cigarette Tax Rates and Revenue—Table 1 was set up primarily to provide an overall view of the relationships between cigarette tax rates and revenue derived from cigarette taxes. However, the tables, figures, and computations of this section will be based on data from this table.

Table 2 indicates that the excise tax rates applying to cigarettes in only 16 of the 40 states that levied cigarette taxes in 1950 were higher than the three cents per package rate levied in Illinois. By the fiscal year ending

*The author is Assistant Professor of Social Sciences at Western Illinois University.

[1] *Seventeenth Annual Report of the Department of Revenue,* Springfield, Illinois, 1960, p. 16.

TABLE 1

State Cigarette Tax Rates and Revenue*

State	Cigarette Tax Rates (Cents Per Package)			Gross Cigarette Revenue 1960¶ (000)	Per Capita Cigarette Revenue 1960¶	Per Capita Income 1959
	1950†	1960‡	1961§			
Alabama	3	6	6	$ 15,848	$4.85	$1,409
Alaska	—	5	5	1,231	5.45	2,550
Arizona	2	2	2	3,201	2.46	1,959
Arkansas	4	6	6	9,437	5.28	1,322
California	—	3	3	65,157	4.15	2,661
Connecticut	3	3	5	11,505	4.54	2,817
Delaware	2	3	3	2,107	4.72	2,946
Florida	5	5	5	33,267	6.72	1,980
Georgia	5	5	5	19,572	5.01	1,553
Hawaii	—	3.9	3.9	1,725	2.73	2,139
Idaho	3	5	6	3,316	4.97	1,782
Illinois	3	4	4	51,038	5.06	2.610
Indiana	3	3	3	17,839	3.83	2,102
Iowa	2	4	4	11,911	4.32	1,953
Kansas	3	4	4	9,225	4.23	1,994
Kentucky	2	3	2.5	10.275	3.38	1,514
Louisiana	8	8	8	27,787	8.53	1,575
Maine	4	5	6	6,788	7.01	1,768
Maryland	—	3	6	11,492	3.71	2,343
Massachusetts	5	6	6	39,992	7.77	2.444
Michigan	3	6	5	52,488	6.71	2,253
Minnesota	4	5.5	7	20.028	5.87	1,962
Mississippi	4	6	6	10,901	5.01	1,162
Missouri	—	2	4	11,470	2.66	2,145
Montana	2	8	8	6,149	9.11	1,955
Nebraska	3	4	4	6,276	4.45	1,981
Nevada	3	3	7	1,669	5.86	2,745
New Hampshire	2.5	3.5	3.5	4,018	6.62	2,010
New Jersey	3	5	7	42.038	6.93	2,608
New Mexico	4	5	8	4,830	5.08	1,833
New York	3	5	5	120,505	7.18	2,736
North Dakota	5	6	6	3,675	5.81	1,526
Ohio	2	5	5	62,615	6.45	2,328
Oklahoma	5	5	7	12,989	5.58	1,786
Pennsylvania	4	6	6	80,351	7.10	2,222
Rhode Island	3	6	6	6,223	7.24	2,156
South Carolina	5	5	5	10.265	4.31	1,332

TABLE 1 (Continued)

State	Cigarette Tax Rates (Cents Per Package) 1950†	1960‡	1961§	Gross Cigarette Revenue 1960¶ (000)	Per Capita Cigarette Revenue 1960¶	Per Capita Income 1959
South Dakota	3	5	5	3,518	5.17	1,476
Tennessee	3	5	5	17,500	4.91	1,521
Texas	4	8	8	74,556	7.78	1,908
Utah	2	4	4	2,420	2.72	1,848
Vermont	4	7	7	3,302	8.47	1,789
Virginia	—	—	3	—	—	—
Washington	4	6	7	17,514	6.14	2,271
West Virginia	1	5	6	9,927	5.34	1,635
Wisconsin	3	5	5	22,073	5.59	2,116
Wyoming	—	4	4	1,827	5.54	2,149

*SOURCE: Cigarette tax rates and groww cigarette revenue from—*Cigaret Taxes in the United States*, Tobacco Tax Council, Richmond, Virginia, 1961. Population (April 1, 1960) used in computing per capita cigarette revenue, and per capita income data from—U.S. Bureau of the Census, *Compendium of State Government Finances in 1961*, Washington, D. C., 1962, p. 56.
†Rates as of July 1, 1950.
‡Rates for the fiscal year ending June 30, 1960.
§Rates as of July 1, 1961.
¶Revenue collected during the fiscal year ending June 30, 1960.

June 30, 1960, both the mode and the median had increased from three cents per package to five cents per package. During this fiscal year, the rates in 29 states were higher than the four cents per package rate levied in Illinois. In the calendar year 1961, seventeen states increased their cigarette tax rates.[2] The rate of four cents per package currently levied in Illinois is low in relation to the rates of the other states that levy specific excise taxes on cigarettes. The rates in 33 states are higher than the rate levied in Illinois, whereas, the rates in only seven states are lower than the rate level in Illinois.

An examination of data from Table 1 of per capita cigarette revenue for the fiscal year ending June 30, 1960, and cigarette tax rates for that same fiscal year indicates that there is a direct relationship between tax rates and per capita revenue. The data representing cigarette tax rates and per capita state cigarette revenue were plotted on Figure 1. A linear regression curve was drawn, and the resulting correlation coefficient of .7858 between the variation in cigarette tax rates and the variation in per capita cigarette revenue indicates that there was a highly significant relationship between those two variables.[3] The coefficient of determination (r^2) of .62 indicates that approximately 62 percent of the total variation in per capita cigarette revenue has been accounted for by the variation in cigarette tax rates.

[2] The significance of these, as well as other, rate increases will be investigated in a later section of this chapter.
[3] The critical value of r at the 1 percent level of significance with 45 observations and two variables is .372. See, Robert Ferber, "5 and 1 Percent Significance Points for r and R for Regressions Containing Up to Five Variables," *Statistical Techniques in Market Research*, (New York: McGraw-Hill Book Company, Inc., 1949), p. 521.

TABLE 2

State Cigarette Tax Rates*

Rate (Cents Per Package)	Number of States Using Specific Rate		
	July 1, 1950	Fiscal Year Ending June 30, 1960	November 30, 1961†
1	1	—	—
2	7	2	1
2.5	1	—	1
3	15‡	7	3
3.5	—	1	1
3.9	—	1	1
4	9	6‡	7‡§
5	6	15	10
5.5	—	1	—
6	—	9	12
7	—	1	6
8	1	3	5
Number of States	40	46	47
Median	3	5	5
Mode	3	5	6

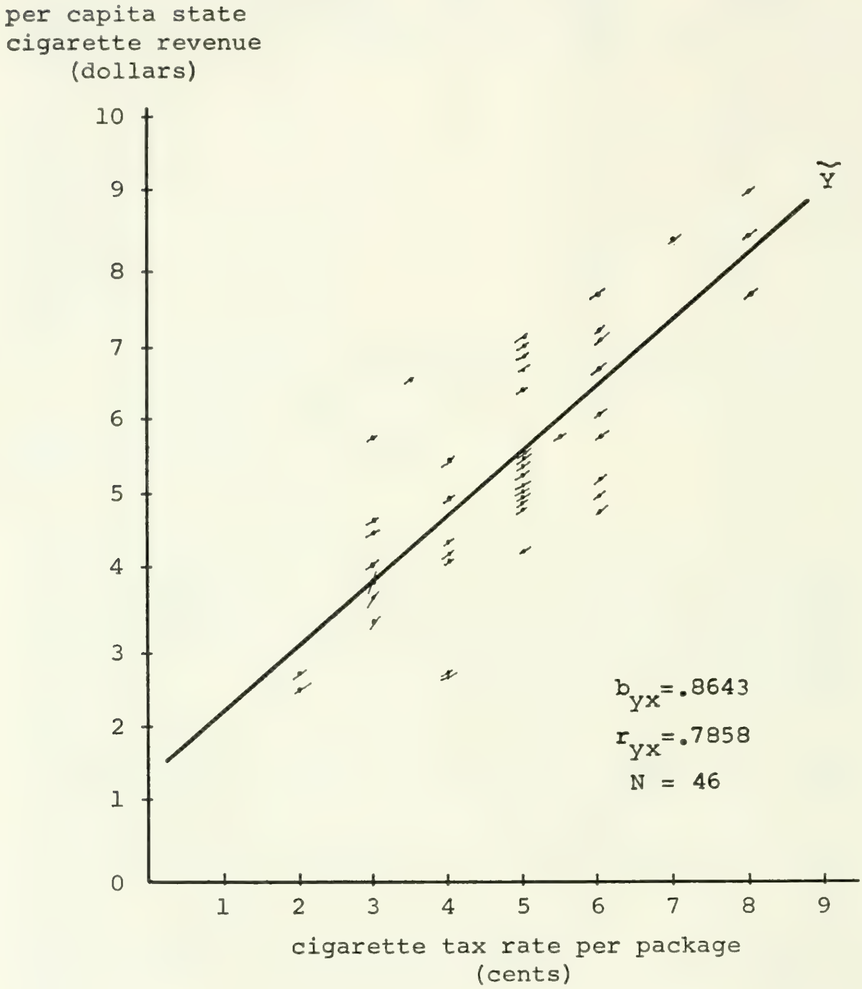
*SOURCE: Table 1.
†Between July 1, 1961, and November 30, 1961, Alaska increased its rate from 5 cents to 8 cents, Delaware from 3 cents to 5 cents, and Wisconsin from 5 cents to 6 cents. Source: Tobacco Tax Council.
‡The State of Illinois falls into this group.
§The rate in Illinois was 3 cents per package for the greater part of the fiscal year ending June 30, 1961.

A linear regression was also computed for the relationship between per capita income and per capita cigarette tax revenue, but the resulting correlation coefficient of .065 indicated that there was no significant relationship between the variation in per capita income and the variation in per capita cigarette revenue. However, upon observing the raw data of Table 1 it appeared that a combination of the variation in cigarette tax rates and the variation in per capita income would cause a substantial reduction in the unexplained variance which resulted when the variation in cigarette tax rates alone was correlated with the variation in per capita state cigarette revenue. To test this hypothesis, a three variable multiple correlation test was run in which the variation in cigarette tax rates and the variation in per capita income were the independent variables, and the variation in per capita state cigarette revenue was the dependent variable. The multiple correlation coefficient obtained was .8764, which is highly significant at the 1 percent level.[4] The computed coefficient of determination ($R^2y_{.12}$) of .7684

[4] With 45 observations and three variables the critical value of R at the 1 percent level of significance is .430. See, Ferber, *op. cit.*, p. 521.

FIGURE 1

Regression of Cigarette Tax Rates on
Per Capita Cigarette Revenue (1960)



indicated that approximately 77 percent of the variation in per capita state cigarette tax revenue had been explained by the multiple regression.

The simple regression of the variation in cigarette tax rates and the variation in per capita state cigarette revenue had explained approximately 62 percent of the variation in per capita state cigarette revenue, which left 38 percent of the variation unexplained. Since the multiple regression had explained about 77 percent of the total variation in per capita state cigarette

revenue, an additional 15 percent of the variation had been explained by the multiple regression. Approximately 38 percent ($r^2y_{2.1}$) of this newly explained variation was a result of adding the variation in per capita income to the multiple regression.[5]

Significance of the Relationship Between Rates and Revenue — The steep slope of the regression line of Figure 1 indicates that the demand for cigarettes is relatively inelastic, which means that if an additional tax is levied on cigarettes in a specific state, total cigarette tax revenue should increase greatly since the increased price to the consumer caused by the tax increase will not result in a proportionate reduction in sales.[6]

It is quite obvious that the increases in cigarette tax rates as shown in Table 2, are a result of state legislatures being cognizant of this inelastic demand for cigarettes in their quest for additional revenue. From Table 3 it can be seen that cigarette tax revenues for the fiscal year ending June 30, 1958, had increased by an average of 44.3 percent over 1957 revenues in those six states in which cigarette tax rates were increased during that time period. Between 1957, and 1958, cigarette tax revenue increased by an average of only 4.3 percent in the 37 states in which no appreciable tax rate increases had occurred. Between 1958 and 1959 the cigarette tax rates in two states were increased from five to six cents per package. The average increase in cigarette revenue for these two states was 24.1 percent, while in the 41 states in which no significant rate increases had occurred, the average increase in cigarette tax revenue was 9.97 percent. The change in cigarette tax revenue between 1959 and 1960 was 38.4 percent in those states in which cigarette tax rates were higher in 1960 than they were in 1959. However, in those states in which no significant rate increases occurred the increase in cigarette revenue was only 7.2 percent.

In two states cigarette tax rates were reduced between the fiscal year ending June 30, 1960, and June 30, 1961. In both states total cigarette revenue fell. The rate in Kentucky was reduced from three cents per package to 2.5 cents per package on July 1, 1960. Cigarette tax revenue in Kentucky was 10.1 percent lower during the fiscal year ending June 30, 1961, than it was during the previous fiscal year.[7] On June 8, 1960, the cigarette tax rate in Illinois was reduced from four to three cents per package, and remained

---

[5] The correlation coefficients used in computing the multiple correlation coefficient were: ry_1 equal .7858, ry_2 equal .06495, and r_{12} equal minus .3679. The partial coefficient $Y_{1.2}$ equal .8727, and its t equal 11.8562. The partial coefficient $Y_{2.1}$ equal .6157, and its t equal 5.1830. With as few as thirty observations, a value of t of 2.750 is significant at the 1 percent level. See, Ferber, *op. cit.*, p. 487.

[6] In commenting on the elasticity of demand of tobacco products Professor Harold M. Groves said: "Outside its ease of collection, the tobacco tax has appeal the world over because the demand for tobacco is highly inelastic. This permits the tax makers to hand a fantastic tax on an otherwise cheap product and keep the consumer coming back for more. Tobacco consumption falls in the area of compensatory psychology. One 'needs a smoke' largely to favor himself in moments of boredom and fatigue. The more the favor costs the individual the greater favor it constitutes. The British, partly to conserve foreign exchange, have put this theory to its severest test and it has held up remarkably well." Harold M. Groves, *Financing Government*, Henry Holt and Co., New York, 1959, pp. 258-259.

[7] Cigarette tax revenue in Kentucky during the fiscal year ending June 30, 1960, was $10,275,-000. The state collected only $9,234,000 during the next fiscal year. Source: Tobacco Tax Council.

TABLE 3

Cigarette Tax Rate and Revenue Increases
(Fiscal Years 1957-1958, 1958-1959, 1959-1960)*

	Cigarette Tax Rate (Cents Per Package)		Gross Cigarette Revenue (000)		Percentage Change From
State	1957	1958	1957	1958	1957 to 1958
Michigan	3	5	$ 27,456	$ 43,149	57.2
Montana	5	8	3,286	5,410	64.6
Nebraska	3	4	4,133	5,231	26.6
Vermont	4	5	1,945	2,357	21.2
Wisconsin	4	5	15,414	19,211	24.6
Wyoming	2	3	794	1,173	47.7
Total for Six States			53,028	76,531	44.3
Total for Remaining 37 States			553,852	577,816	4.3
State	1958	1959	1958	1959	1958 to 1959
Massachusetts	5	6	30,847	38,093	23.5
Mississippi	5	6	8,068	10,180	26.2
Total for Two States			38,915	48,273	24.1
Total for Remaining 41 States			615,432	676,811	9.97
State	1959	1960	1959	1960	1959 to 1960
Alabama	4	6	11,488	15,848	37.95
Idaho	4	5	2,565	3,316	29.3
Illinois	3	4	39,122	51,038	30.5
Iowa	3	4	8,876	11,911	34.2
Minnesota	4	5.5	14,314	20,028	39.9
New York†	3	5	84,717	120,505	42.2
Ohio‡	3	5	37,480	62,615	67.1
Pennsylvania‡	5	6	66,490	80,351	20.9
South Carolina	3	5	6,663	10,265	54.1
South Dakota	3.25	5	2,234	3,518	57.5
Texas	5	8	51,453	74,556	44.9
Vermont	5	7	2,599	3,302	27.1
Washington‡	5	6	15,001	17,514	16.8
Wyoming	3	4	1,253	1,827	45.8
Total for 14 States			344,255	476,594	38.4
Total for Remaining 31 States			393,003	421,409	7.2

*Includes only those states in which the tax rate was increased by at least one cent per package, and where the higher rate applied for at least nine months of the fiscal year (totals include the District of Columbia). Source: Tobacco Tax Council.
†Rate increased from 3 cents to 5 cents April 1, 1959.
‡The 1960 rate became effective June 1, 1959.

at the three cents per package rate until May 1, 1961, at which time it was again increased to four cents per package. In other words, the rate in Illinois was three cents per package for ten of the twelve months of the fiscal year ending June 30, 1961. The rate for ten of the twelve months of the previous fiscal year was four cents per package. This rate reduction in Illinois resulted in a 13.3 percent decline in cigarette tax revenue.[8]

A closer look at Table 3 indicates that cigarette tax revenue increased from about 15 percent to 30 percent per one cent increase in cigarette tax rates, with between 20 and 25 percent being the most frequent change per one cent increase in tax rates. There were, of course, exceptions to this generalization. In Wyoming, a change of from two cents per package to three cents per package between 1957 and 1958 resulted in a 47.7 percent increase in state cigarette tax revenue. In that same state, between 1959 and 1960 an additional one cent per package rate increase resulted in a 45.8 percent increase in cigarette tax revenue. However, a tax increase of two cents per package in Vermont between 1959 and 1960 resulted in only a 13.55 percent increase in cigarette tax revenue per one cent increase in the tax rate.

From Table 3 it can also be seen that, in general, the higher the original rate, the lower will be the percentage change in revenue per one cent increase in the tax rate. This indicates that the demand for cigarettes becomes more elastic as the price increases.[9]

Potential Revenue to Illinois if Cigarette Tax Rates are Increased — Without setting up complex mathematical prediction equations it is possible, on the basis of the preceding analysis, to estimate the additional cigarette tax revenue that Illinois could collect if cigarette tax rates are increased in that State.

As stated above, the cigarette tax rate in Illinois was three cents per package for ten months of the fiscal year ending June 30, 1961. The rate of four cents per package during the fiscal year ending June 30, 1962 should result in an increase in gross cigarette revenue of approximately 25 percent. Assuming 1961 tax collections were $44,270,000, as reported by the Tobacco Tax Council, the gross cigarette revenue for the fiscal year ending June 30, 1962, should be about $55,337,500, which represents an increase of slightly over $11 million. A one cent increase in the Illinois cigarette tax rate (from 4 cents to 5 cents per package) should result in a 20 percent increase in gross cigarette tax revenue. If the rate is increased by two cents per package, gross collections from this source should increase by about 38 percent, and a three cent per package rate increase should result in approximately a 54 percent increase in gross cigarette tax revenue.[10] In terms of dollars and

[8] Cigarette tax revenue in Illinois during the fiscal year ending June 30, 1960, was $51,038,000. The State collected only $44,270,00 during the next fiscal year. Source: Tobacco Tax Council.

[9] Given a linear demand curve (with the exception of a perfectly elastic or perfectly inelastic curve) an increase in price must result in an elasticity coefficient greater than the elasticity coefficient that corresponds to the lower price. However, this need not be the case for a curvilinear demand curve. It is possible for a demand curve to be more inelastic at higher prices than at lower prices.

[10] These predictions assume no major population changes, no major changes in business activity or employment, and no great inflationary pressures.

cents, an increase in the cigarette tax rate of one cent per package, bringing the total rate to five cents per package, should increase gross cigarette tax revenue by slightly over $11 million annually. If the cigarette tax rate in Illinois should be increased to six cents per package, gross cigarette tax revenue should increase by slightly over $21 million annually and a rate of seven cents per package should result in an increase in cigarette revenue of slightly under $30 million annually.

A rate increase of one, two, or even three cents per package would not put the cigarette tax rate in Illinois out of line with the rates in other cigarette taxing states. In fact, upon observing data from Table 2 it can be seen that if the rate in Illinois had been six cents per package on November 30, 1961, both the mode and the median rate for that year would have been six cents per package. In addition, since the demand for cigarettes appears to be quite inelastic, other states are certain to increase their rates to six, seven, and even eight cents per package.

Should Cigarette Tax Rates be Increased in Illinois?—Cigarettes are among the highest taxed commodities in the United States today. According to a recent study made by the Tobacco Tax Council, the average (median) retail price per package of twenty cigarettes is 26.9 cents. The average tax, including the federal levy of eight cents per package, is 13 cents per package, or 48.3 percent of the retail price.[11] In twenty-one states the combined federal and state excise taxes account for 50 percent or more of the retail selling price.[12] In Illinois federal and state excise taxes account for 46.2 percent of the average retail price.[13] However, when state and local retail sales taxes are taken into consideration, taxes in Illinois account for slightly over 48 percent of the final retail price.

Proponents of higher cigarette tax rates argue that rates should be increased because of the great revenue possibilities of this tax. The argument can not be refuted on technical grounds. A cigarette tax rate increase in Illinois will result in a considerable increase to state tax revenue. However, the cigarette tax is an extremely regressive tax, in fact, it may be the most regressive tax in our tax system today. People with low incomes spend a higher proportion of their incomes on cigarettes, and consequently, pay a higher percentage of their incomes to government in the form of cigarette taxes than do people with higher incomes.[14] Total taxes levied on cigarettes

[11] *Cigaret Taxes in the United States*, Tobacco Tax Council, Richmond, Virginia, 1961, p. 19.
[12] *Ibid.*, p. 19.
[13] *Ibid.*, p. 19.
[14] Processing the raw data included in a study prepared by the United States Bureau of Labor Statistics shows that:

Income Class (1950)	Percentage of Income After Taxes Spent on Tobacco Products
$1,000 to $2,000	(1950)
3,000 to 4,000	2.35
5,000 to 6,000	2.01
over $10,000	1.59
	0.69

SOURCE: *Study of Consumer Expenditures, Incomes and Savings*, Statistical Tables, Urban U. S.—1950, from the Survey of Consumer Expenditures in 1950, prepared by the Bureau of Labor Statistics, U. S. Department of Labor for the Wharton School of Finance and Commerce, University of Pennsylvania.

are even more regressive since 24 of the 37 states that levy retail sales taxes include cigarettes in their tax base.[15] An increase in cigarette tax rates will unquestionably shift a good share of the burden of Illinois' additional revenue to the very bottom of the income scale.

With respect to this form of taxation Professor Henry Simons said:

> These taxes, to my mind, are the worst elements in our revenue system. They are much more regressive than sales taxes. They are almost wholly concealed, precluding real awareness by individuals of their actual annual burden. They pander to misguided demands for sumptuary legislation, deriving strong support from alleged purposes which they are carefully designed not to serve. They pose as levies upon "luxuries," while serving to divert expenditure not from the objects taxed, but from "necessities." Like corporation taxes, they are the revenue devices of political cowards who live in terror of voter-taxpayers and of government by intelligent discussion. The only cogent defense of them rests on the Calvinist premise that poor consumers of the objects in question are obviously damned for the next life and may properly be prepared now for their fate, by carrying what would otherwise be tax burdens of the elect.[16]

Apart from the quest for additional revenue, the Legislature must decide if it wishes to retain its regressive tax structure. The tax system in Illinois is more regressive than the tax systems of most other states. For example, in 1961, sales and gross receipts taxes (highly regressive taxes) accounted for approximately 58 percent of total tax revenue for the fifty states. However, during that same year, these taxes accounted for slightly over 81 percent of total tax revenue in Illinois.[17]

On the basis of the already regressive tax structure in Illinois, the extremely regressive nature of the cigarette tax, and the fact that taxes account for over 48 percent of the retail price of a package of cigarettes, this writer recommends that the cigarette tax rate in Illinois should not be increased.

Other Tobacco Taxes

On September 1, 1960, only 18 states levied taxes on the distribution of "non-cigarette" tobacco products such as cigars, smoking tobacco, chewing tobacco, and snuff. Illinois was one of the 32 states that did not levy taxes on these other tobacco products.

There are two general methods of taxing these other tobacco products. A tax in the form of a specific percentage of the wholesale price was imposed in Hawaii, Michigan, Minnesota, New York, Vermont, and Washington. Eleven states levied either per unit taxes or a combination of per unit

[15] *Op. cit., Cigaret Taxes in the United States*, p. 20.

[16] Henry C. Simons, *Federal Tax Reform.* (Chicago: University of Chicago Press, 1950), pp. 36-37.

[17] In 1961, total state tax revenue was $19,057,452,000, while total sales and gross receipts revenue was $11,031,259,000. In Illinois during 1961, total tax revenue was $874,310,000, and sales and gross receipts revenue was $711,125,000. Source: *Compendium of State Government Finances in 1961*, (Washington, D. C.: U. S. Bureau of the Census, 1962), p. 11.

TABLE 4

State Tobacco Tax Rates*
As of September 1, 1960

State	Cigars (Per 1,000)	Smoking Tobacco	Chewing Tobacco and Snuff
Alabama	$1.50-$20.25	†	.75¢ per ounce‡§
Arizona	$1.00-$10.00	1¢ per ounce	.25¢ per ounce¶
Georgia	$1.50-$20.00	—	—
Hawaii		— 20% of wholesale price —	
Louisiana	$1.20-$40.00	•	—
Michigan		— 20% of wholesale price —	
Minnesota		— 20% of wholesale price —	
Mississippi	$1.20-$16.80**	1¢ for each 5¢ of retail price§	.5¢ per each 5¢ of retail price§
New Hampshire		— 15% of retail price —	
New York		— 15% of wholesale price —	
North Dakota		—	2¢ per 1¼ ounces§††
Oklahoma	$2.50-$10.00**	— 20% of factory list price —	
South Carolina	$2.00-$16.00	2¢ for first 10¢ of retail price plus 2¢ for each additional 5¢§	1¢ for each 2 ounces§
Tennessee	$1.00-$13.50**	— 5% of retail price —	
Texas	$1.00-$15.00	— 25% of factory list price‡‡ —	
Vermont		— 20% of wholesale price —	
Virginia	$1.00-$13.50**	—	—
Washington		— 25% of wholesale price —	

*In addition to these rates, there are special taxes on wholesalers and retailers. Source: *Facts and Figures on Government Finance, 1960 1961*, (New York: Tax Foundation, Inc., 1961), p. 195. Alabama cigar tax rates from: The Department of Revenue, Montgomery, Alabama.
†Range from 2 cents on package of 1⅛ ounces or less to 5 cents on first 2 ounces plus 3 cents for each additional ounce or fraction thereof. Source: The Department of Revenue, Montgomery, Alabama.
‡Applies to chewing tobacco only; snuff taxed at rates ranging from ½ cent on packages of ⅝ ounces or less to 4 cents on first 6 ounces plus 1 cent for each additional ounce.
§Rate applies to base and any fraction thereof.
¶Applies to chewing tobacco only; snuff taxed at 1 cent per ounce.
•Rates range from 1 cent on first 5 cents of selling price to 4 cents on first 15 cents plus 1 1/3 for each additional 5 cents of selling price.
**Rate based wholly or in part on retail sales price.
††Applies to snuff only.
‡‡Does not apply to snuff.

and ad valorem taxes, while New Hampshire imposed a tax in the form of a specific percentage of the retail selling price.

Table 4 is self-explanatory, except for the rates applying to cigars. A typical breakdown of the cigar tax can be shown by making reference to the Georgia Cigar and Cigarette Tax Law. The pertinent section of this law reads as follows:

> Section 3. (a) A privilege tax is hereby levied on every person selling cigars and cigarettes or possessing cigars or cigarettes for sale, said tax to be measured by and graduated in accordance with the volume of cigars or cigarettes sold or possessed for sale as follows:
> Little cigars:
> weighing not more than three pounds per thousand—two (2) mills each.

Cigars:

retailing for three and one-third (.03-1/3) cents each or less—one dollar and fifty cents ($1.50) per thousand;

retailing for more than three and one-third (.03-1/3) cents each and not more than five (.05) cents each—three dollars ($3.00) per thousand;

retailing for more than five (.05) cents each and not exceeding eight (.08) cents each—four dollars ($4.00) per thousand;

retailing for more than eight (.08) cents each and not exceeding ten (.10) cents each—seven dollars and fifty cents ($7.50) per thousand;

retailing for more than ten (.10) cents each and not exceeding twenty (.20) cents each—fifteen dollars ($15.00) per thousand;

retailing for more than twenty (.20) cents each—twenty dollars ($20.00) per thousand.[18]

As can be seen from Table 4 and the breakdown of Georgia's cigar tax rates, taxes on cigars, and in several states taxes on smoking tobacco, chewing tobacco and snuff tend to be progressive. That is as the price of the product increases, the tax rate per unit increases. This means that, in the case of cigars, a person with a low income can reduce his tax burden by purchasing lower priced cigars. Under the present cigarette tax structure this reduction in the tax burden is not possible because the same per unit tax rate applies regardless of the quality of the product or the final retail price.

Both gross and net state tax collections from other tobacco products are included in Table 5. Net collections equal gross collections minus amounts allowed for affixing tax indicia. Net revenue data were used in computing per capita revenue from other tobacco products, whereas gross revenue data were used in computing per capita cigarette revenue. Gross figures were used for cigarette tax revenue because each state that levies taxes on cigarettes uses the same method of taxation, that is, a specific tax per package, and any variation among the states between gross revenue and net revenue must result from the methods of enforcement rather than from the method of taxation. However, in the case of other tobacco products, a comparison of gross revenue and net revenue is important since the various methods of taxing other tobacco products may result in a variation in the cost of collection.

Data from Table 5 indicate that net revenue as a percentage of gross revenue was higher in those states that levied taxes in the form of a specific percentage of the wholesale price than in those states in which other forms of taxation were used. The average net revenue as a percentage of gross revenue was 97.6. In each of the six states that levied wholesale taxes, net revenue as a percentage of gross revenue was higher than the average of the 18 states. Texas was the only other state in which net revenue as a percentage of gross revenue was greater than the average of 97.6, and in that state net

[18] Georgia Laws, 1955, p. 268.

TABLE 5

State Tax Revenue from Other Tobacco Products*
(Fiscal Year Ending June 30, 1961)

State	Other Products Taxed†	Gross Revenue (000)	Net Revenue (000)	Net Revenue As a Percentage of Gross Revenue	Per Capita Net Revenue‡
Alabama	CSChSn	$ 1,776	$ 1,642	92	.50
Arizona	CSChSn	511	486	95	.37
Georgia	C	651	634	97	.16
Hawaii	CSChSn	281	281	100	.44
Louisiana	CS	1,507	1,372	91	.42
Michigan	CSChSn	4,427	4,383	99	.56
Minnesota	CSChSn	1,639	1,599	98	.47
Mississippi	CSChSn	1,281	1,153	90	.53
New Hampshire	CSChSn	311	295	95	.49
New York	CSChSn	7,705	7,682	99.7	.46
North Dakota	Sn	42	40	95	.06
Oklahoma	CSCh	1,473	1,415	96	.61
South Carolina	CSChSn	1,873	1,779	95	.75
Tennessee	CSChSn	820	779	95	.22
Texas	CSCh	6,827	6,827	100	.71
Vermont	CSChSn	232	227	98	.58
Virginia	C	500	476	95	.12
Washington	CSChSn	1,322	1,322	100	.46
Total		$33,179	$32,392	97.6	.47

*SOURCE: *Cigaret Taxes in the United States, Op. cit.*, p. 18.
†C—Cigars Ch—Chewing tobacco
S—Smoking tobacco Sn—Snuff
‡Population as of April 1, 1960.
Compendium, Op cit., p. 56.

revenue equaled gross revenue. This seems to indicate that, in general, the cost of collection is less in the "wholesale" states than in the other states. However, of the eight states in which per capita net revenue from other tobacco products was higher than the 18 state average of $0.47, only two were "wholesale" states, which indicates that the cost of collection certainly is not the major determinant of per capita net revenue.

The lowest levels of per capita net revenue were in states that levied taxes only on cigars or snuff.[19] Per capita revenue from other tobacco products were quite low in Arizona and Tennessee even though taxes were levied on all forms of other tobacco products in both states. However, tax rates were low in these two states in relation to rates in the other 16 states (see Table 4).

There appears to be no relationship between tax rates and per capita

[19] Georgia, North Dakota, and Virginia (see Table 4).

net revenue from other tobacco products in the "wholesale" states. Per capita net revenue was low in both New York, the "wholesale" state with the lowest rate, and Washington, the "wholesale" state with the highest tax rate. The tax rate was 20 percent in each of the other "wholesale" states, but per capita net revenue in these states ranged from 44 cents to 58 cents.

Tax rates were high in all five "non-wholesale" states in which per capita revenue was $0.50 or more. A comparison of data from Table 4 and Table 5 would lead one to believe that, as with the case of cigarettes, there is a direct relationship between tax rates on other tobacco products and tax revenue derived from these products. Information supplied by state tax administrators seem to substantiate this hypothesis. According to H. S. Phifer, Chief, Tobacco Tax Division of the State of Alabama, tax rates on other tobacco products were approximately 50 percent higher in the fiscal year ending September 30, 1960, than they were in the previous fiscal year. Total tobacco tax revenue (including cigarette revenue) was 56 percent higher in 1960 than it was in 1959.[20] During that same time period, cigarette tax rates in Alabama were increased from four cents to six cents per package. Cigarette tax revenue in that state was 37.95 percent higher in 1960 than it was in 1959 (see Table 3). Since total tobacco tax revenue increased by 56 percent, cigarette tax revenue increased by approximately 38 percent, and since the revenue from non-cigarette tobacco products represents a very small percentage of total tobacco tax revenue (8.9 percent in Alabama for 1961)[21] the increase in non-cigarette tax revenue during that time period must have been greater than 200 percent.[22]

In Oklahoma, tax rates on other (non-cigarette) tobacco products were increased as of May, 1961. The old tax rate on cigars ranged from $2.50 per thousand to $10.00 per thousand. Smoking tobacco and chewing tobacco were taxed at a rate of 20 percent of the regular factory list price. Snuff is not taxed in Oklahoma. However, there was a tax of 20 percent of the regular factory list price levied upon this product from July 1, 1961, through October 26, 1961.[23] Oklahoma now levies a tax of $3.50 per thousand on little cigars weighing not more than three pounds per thousand,

---

[20] Total tobacco tax revenue in 1958-1959 was $11,739,945.56, and in 1959-1960 it was $18,422,-820.95. SOURCE: H. S. Phifer, Chief, Tobacco Tax Division of the State of Alabama.

[21] *Op. cit., Cigaret Taxes in the United States*, p. 18.

[22] Assume:

X_1 equal total tobacco tax revenue during fiscal 1958-1959

Y_1 equal total cigarette tax revenue during fiscal 1958-1959

W_1 equal total other tobacco products tax revenue during fiscal 1958-1959

W_1 equal $.089X_1$

Y_1 equal $.911X_1$

.56 equal the percentage change in total tobacco revenue

.38 equal the percentage change in cigarette revenue

a equal the percentage change in revenue from other tobacco products

Using the above assumptions we can determine the percentage change in revenue from other tobacco products by using the following equation:

$$.38Y_1 \text{ plus } aW_1 \text{ equals } .56X_1$$

$$a \text{ equals } 2.40 \text{ equal } 240\%$$

[23] The revenue from this tax on snuff amounted to approximately $44,000. SOURCE: A. J. Beddo, Director, Cigarette and Tobacco Division, Oklahoma Tax Commission.

TABLE 6

Tax Rates and Revenue in the "Wholesale" States*
(Fiscal Year Ending June 30, 1961)

State†	Tax Rate as Percentage of Wholesale Price	Per Capita Net Revenue
Hawaii	20	$0.44
Michigan	20	0.56
Minnesota	20	0.47
New York	15	0.46
Vermont	20	0.58
Washington	25	0.46
Average of All 18 States		$0.47

*SOURCE: Tables 4 and 5.
†All six states levied a tax on cigars, smoking tobacco, chewing tobacco, and snuff.

$10.00 per thousand (1 cent per cigar) on all cigars weighing more than three pounds per thousand and retailing for 3 1/3 cents each, or less, and $20.00 per thousand (2 cents per cigar) on all cigars weighing more than three pounds per thousand and retailing for more than 3 1/3 cents each.[24] Smoking tobacco is now taxed at the rate of 25 percent of the regular factory list price, and the tax on chewing tobacco remains at 20 percent of the regular factory list price.[25]

Net revenue from other tobacco products in Oklahoma during the fiscal year 1960-1961 was $1,415,489.33. For the first eleven months of the fiscal year 1961-1962 net revenue from other tobacco products was $1,937,-198.03.[26] Assuming that total collections from other tobacco products during June of 1962 will be the same as the average collections of the other eleven months, net revenue from other tobacco products should be approximately $2,113,306.94, which is a 49 percent increase over the previous year's collections. The overall tax rate increase in Oklahoma was less than 50 percent, but revenue from other tobacco products increased by about 50 percent.

Compliance on the Taxation of Other Tobacco Products—The fact that states, such as Illinois, that do not now levy taxes on other tobacco products could receive substantial revenue from this source is not open to question. However, questions have been raised about methods of securing compliance on the taxation of other tobacco products.

There are two specific problems in the area of compliance. The first is the problem of obtaining some sort of visible evidence that the tax has been paid, as is done through the stamp imprint on cigarettes. The second problem is the collection of the tax on other tobacco products purchased outside the taxing state.

[24] Oklahoma Enrolled House Bill No. 800, approved May 24, 1961.
[25] *Ibid.*
[26] *Op. cit.*, Beddo.

In 1949, the Federal Government passed a law (the Jenkins Act) that was designed to aid states in the collection of cigarette taxes on cigarettes purchased outside the taxing state by requiring out of state sellers to notify the Department of Revenue of the taxing state of all shipments of cigarettes going into that state. The pertinent section of this law reads:

> Sec. 2. Any person selling or disposing of cigarettes to interstate commerce whereby such cigarettes are shipped to other than a distributor licensed by or located in a state taxing the sale or use of cigarettes shall, not later than the 10th day of each month, forward to the tobacco tax administrator of the state into which such shipment is made a memorandum or a copy of the invoice covering each and every such shipment of cigarettes made during the previous calendar month into said state; the memorandum or invoice in each case to include the name and address of the person to whom the shipment was made, the brand, and the quantity thereof.[27]

The Jenkins Act assists only those states that levy cigarette use taxes. A cigarette use tax was adopted in Illinois in 1951. A section of the *Sixteenth Annual Report of the Department of Revenue* of the State of Illinois reads: "The Cigarette Use Tax Act, which complements the Cigarette Tax Act, has been sustained by the courts. This law enables the Department to collect the cigarette tax directly from users who buy their cigarettes by mail outside Illinois."[28] Whereas the Jenkins Act assists tax administrators in collecting cigarette taxes on interstate shipments, it does not apply to shipments of other tobacco products, such as cigars, smoking tobacco, chewing tobacco, and snuff.

This writer communicated with the tobacco tax administrators in twelve of the states that levy taxes on other tobacco products, inquiring into the matter of compliance. At the time of this writing, nine tax administrators had either replied personally, or had sent copies of their tobacco tax laws.

The only pessimistic reply came from a tax administrator in New York, a "wholesale" state, where a tax on other tobacco products was levied from July 1, 1959, through June 30, 1961. John J. Purcell, Assistant Director of the New York State Tax Commission sent this writer " . . . a copy of our May 16, 1961 letter to Mr. Charles Merideth, Legislative Representative, Illinois Association of Tobacco Distributors, prepared by this Bureau for Commissioner Murphy's signature."[29] The letter indicated that the Tax Commission had difficulty in determining the wholesale price of tobacco products, and that the industry did "everything it could" to keep down the wholesale price. An additional problem in New York was that no floor tax was levied, and, consequently, distributors "loaded up" prior to the date the tax became effective. The Commission said that the lack of a floor tax was responsible for the small collections during the first three months of the

[27] U.S. Public Law 363—81st Congress, 1949.
[28] *Sixteenth Annual Report of the Department of Revenue*, Springfield, Illinois, 1959, p. 15.
[29] Personal Correspondence, John J. Purcell.

new tax. The letter stated that there was a considerable decline in tobacco sales, especially in New York City, because purchasers could easily buy tobacco products in the nearby states of New Jersey, Connecticut, Pennsylvania, and Massachusetts. This writer feels that some evasion or avoidance of a tax on other tobacco products will probably occur in any state. However, the New York situation is unique because of its close proximity to other urban areas, and the vast amount of people that commute to and from New York City each day. The reply from New York did not indicate whether or not a tax stamp was used to show that the tax had been paid.

Charles Montante, Supervisor of the Miscellaneous Tax Section of the State of Washington, a "wholesale" state, indicated that no major problem regarding tobacco taxation have been encountered there. Mr. Montante stated: "We have a minimum amount of trouble with the collection of this tax and our deliquent accounts are negligible."[30] A tax stamp is not used in Washington to show that the tax has been paid.

In a letter from Michigan, David Parker, Director, Cigarette and Miscellaneous Taxes said that since the tax was a temporary levy, they did not concentrate on enforcement. However, he did state that: " . . . the results were very good in the matter of compliance by the trade."[31] Michigan, a "wholesale" state, did not use the tax stamp plan, but allowed a 1 percent compensation to the wholesaler for remitting the tax.[32] As in New York, Michigan did not levy a floor tax. Mr. Parker said: "The smallness of the first two months collections was the result of a lack of an inventory floor tax when this statute became effective. Consequently the wholesalers had the opportunity of loading up with tax free products prior to the incidence of the tax."[33]

Mr. Lloyd W. Woodruff, Director of Research and Planning Division of the Minnesota Department of Taxation (Minnesota is also a "wholesale" state) said: "Minnesota's tobacco products tax is somewhat more difficult to enforce than the cigarette tax because tobacco products, by their very nature, do not lend themselves to stamping . . . Of course, the use tax enforcement problem is present as with any item subject to a sales or excise tax."[34]

The reply from Virginia did not discuss the problem of interstate compliance. However, it did indicate that wholesalers are authorized to stamp the outside of the master container.[35] Tobacco tax stamps are used in both Georgia and Arizona.[36]

Mr. H. S. Phifer, Chief, Tobacco Tax Division of the State of Alabama wrote: "We use tobacco tax stamps that have been placed on tobacco

[30] Personal Correspondence, Charles Montante.
[31] Personal Correspondence, David Parker.
[32] *Ibid.*
[33] *Ibid.*
[34] Personal Correspondence, Lloyd W. Woodruff.
[35] Personal Correspondence, A. W. Hawkins, Director, Division of Beverage and Tobacco Taxes, The Commonwealth of Virginia.
[36] Georgia, No. 483 (House Bill No. 790), approved February 17, 1960. Arizona Code, Chapter 73, Sections 1401-1412, Luxury Tax Law.

products before they are sold to the retailer. We find that this has been a very satisfactory method of collecting the tax . . ."[37]

Mr. A. J. Beddo, Director, Cigarette and Tobacco Division of the State of Oklahoma, feels that there are no serious problems relating to compliance in his state. Mr. Beddo wrote:

> The responsibility of affixing the tax stamp to the tobacco product is the wholesalers or distributors and we do have a problem, although not serious, in areas along and near the state line where other states do not tax these products. We have wonderful cooperation from our wholesalers and distributors and feel that the evasions on these products are insignificant in relation to the amount of revenue derived from the tax on these products.[38]

Two of the eighteen states that levied taxes on other tobacco products in 1960 have discontinued the tax. Michigan moved out of this field of taxation because the original tax was only a temporary levy. According to the letter to Mr. Merideth, prepared by the New York State Tax Commission, the tax was discontinued in New York because of the problems of compliance. The uniqueness of the New York situation, as indicated above, undoubtedly was the cause of the compliance problems. Tax administrators in the other states in which taxes are levied on other tobacco products did not seem to be too concerned with the problems of compliance. This was especially true in states such as Alabama and Oklahoma in which specific rather than wholesale taxes are levied, and in which tax stamps are affixed to the tobacco products in question.

Potential Revenue from the Taxation of Other Tobacco Products—The average per capita revenue from other tobacco products in the 18 states in which taxes were levied on these products was \$0.47 for the fiscal year ending June 30, 1961. If Illinois would have had a tax on other tobacco products during that fiscal year, and if per capita revenue in Illinois would have been equal to the average of 47 cents, the State would have collected \$4,821,260.00 from that source.[39] If per capita revenue from that source would have been 56 cents as it was in Michigan during that fiscal year, Illinois would have collected \$5,744,480.00.

Of the eight states that were not "wholesale" states, and in which at least three of the four other tobacco products were taxed, two states, Arizona and Tennessee, had low tax rates and consequently low levels of per capita revenue from taxes levied upon other tobacco products. Per capita state tax revenue from these products in the remaining six states were: 50 cents in Alabama; 53 cents in Mississippi; 49 cents in New Hampshire (tax rate was 15 percent of the retail price); 61 cents in Oklahoma (with the new tax rates, per capita revenue in Oklahoma should be approximately 90 cents); 75 cents in South Carolina; and 71 cents in Texas. If Illinois were to adopt

---

[37] *Op. cit.*, Phifer.
[38] *Op. cit.*, Beddo.
[39] The estimated population of Illinois for July 1, 1961, was 10,258,000. SOURCE: *Op. cit.*, *Compendium*, p. 56.

a tax on other tobacco products similar to the old Oklahoma tax of from $2.50 to $10.00 per thousand cigars, and 20 percent of the factory list price of smoking tobacco, chewing tobacco, and snuff, a conservative estimate of per capita revenue from these products would be between 52 cents and 57 cents, or approximately $6,000,000 for the fiscal year. This estimate assumes that an inventory floor tax will be imposed when the tax law becomes effective.

Since there appears to be no relationship between tax rates and per capita revenue in the "wholesale" states (see Table 6), it would be almost impossible to estimate the net revenue the State would collect from a wholesale tax of 20 percent levied on other tobacco products unless additional information on the nature of the demand for these products is available. An "educated guess" of the minimum per capita revenue would be between 47 cents and 50 cents, which would mean net revenue of between $5 million and $5.5 million.

Should Illinois Tax Other Tobacco Products?—A tax on other tobacco products should be levied in Illinois. There is no logical reason why the individual who smokes cigarettes, regardless of his motives, should pay additional taxes to government while the individual who consumes other tobacco products is allowed to enjoy his consumption tax free. With respect to discrimination in the area of tobacco taxation, Professor Harold M. Groves wrote:

> An interesting feature of tobacco taxation is the discrimination shown certain tobacco products in contrast with others. The federal government discriminates only in favor of pipe and chewing tobacco, which pay less than half as much tax ad valorem as cigarettes and cigars. Of the forty-two states (*now 47*) taxing tobacco products in 1956, all but ten (*now 16*) taxed cigarettes only. This favoritism toward the cigar smoker may be explained in two ways: first, the survival of a prejudice against the cigarette and, second, the fact that most politicians have a fondness for a cigar, either for their own consumption or as petty bribery before elections. The trend of demand away from cigars has also been used in support of favored treatment for this tobacco product. From the standpoint of ability to pay, the cigar smoker is at least as able to support the government (and usually more so) as the cigarette smoker.[40]

It is recommended that Illinois levy a tax of $2.00 per thousand on little cigars weighing not more than three pounds per thousand, $10.00 per thousand on all cigars weighing more than three pounds per thousand and retailing for 10 cents, each, or less, $20.00 per thousand on all cigars weighing more than three pounds per thousand and retailing for more than 10 cents, but less than 20 cents each, and $30.00 per thousand on all cigars weighing more than three pounds per thousand and retailing for 20 cents or more per cigar. It is further recommended that a tax of 20 percent of the regular factory list price be levied on smoking tobacco, chewing tobacco, and

[40] *Op. cit.*, Groves, p. 259. Italics added by author.

snuff. An inventory floor tax should be imposed when the law becomes effective, and the tax stamp method should be used to assure compliance. The State should collect from $6 million to $8 million annually from these taxes.

If the demand for other tobacco products in Illinois is as inelastic as the demand for cigarettes, this tax will not result in a substantial decline in retail sales and, consequently, in State and local retail sales tax collections. If the demand for other tobacco products is elastic in Illinois, it is quite possible that the excise tax levied on these products also will not result in a substantial decline in retail sales tax collections. The consumer of a product upon which a new excise tax is being levied can avoid this tax by buying other products. If these other products are included in the retail sales tax base, total retail sales tax collections should not fall. In other words, a tax levied on other tobacco products may result in a reduction in the sales of these products, but an increase in cigarette sales. Retail sales tax collections derived from other tobacco products might decline, but retail sales tax collections (and also specific excise tax collections) derived from cigarette sales might increase. If the excise tax levied on other tobacco products causes a large enough reduction in the sales of these products to force capital out of this industry, property tax bases may not decline to any great extent since part of this capital will flow into other industries.

Summary

Cigarettes are among the highest taxed products in the United States today. When retail sales taxes are included, the average tax per package of cigarettes is approximately 50 percent of the final selling price. The demand for cigarettes is highly inelastic, and, consequently, state excise tax rates applying to cigarettes have increased by 100 percent during the last decade, pouring millions of additional dollars into state treasuries. In one state, cigarette tax revenue increased by 48 percent when the tax rate was increased by only one cent per package. The cigarette tax rate was increased from three cents per package to four cents per package in Illinois on August 1, 1959. Revenue from that source was 30.5 percent higher in that fiscal year than it was in the previous fiscal year.

It is estimated that Illinois could collect an additional $10,000,000 for each one cent increase in its cigarette tax rate. However, it is recommended that cigarette tax rates should not be increased at this time because of the highly regressive nature of this form of taxation. An increase in cigarette tax rates will unquestionably shift a good share of the burden of Illinois' additional revenue to the very bottom of the income scale.

As of January 1, 1962, only 16 states levied taxes on the distribution of other tobacco products such as cigars, smoking tobacco, chewing tobacco, and snuff. There appears to be no logical reason why the consumer of one tobacco product, namely cigarettes, should pay high taxes on his consump-

tion, while the consumer of other tobacco products enjoys his consumption tax free.

The average net per capita tax revenue from other tobacco products in those states in which taxes were levied on those products in 1961 was 47 cents. If Illinois had taxed these other tobacco products in 1961, and if the per capita revenue in Illinois had been equal to the average of 47 cents, the State would have collected approximately $4.8 million dollars.

The State Tax Commission of New York State claimed that the tax on other tobacco products in that State was discontinued because of problems of compliance. However, the New York situation is unique because of its close proximity to other urban areas, and the vast amount of people that commute to and from New York City each day. Tax administrators in other states contacted did not seem concerned with problems of compliance, and seemed pleased with the revenue derived from this source.

It was estimated that if a tax on other tobacco products should be adopted in Illinois, the minimum net revenue from this source would be from $5 million to $8 million annually, depending on the method of taxation employed.

This writer recommended that Illinois adopt a tax on other tobacco products. The rates on cigars should range from $2.00 per thousand on little cigars weighing not more than three pournds per thousand, to $30.00 per thousand on all cigars weighing more than three pounds per thousand and retailing for 20 cents or more per cigar. Smoking tobacco, chewing tobacco, and snuff should be taxed at a rate of 20 percent of the regular factory list price. The tax stamp method should be used to assure compliance, and an inventory floor tax should be imposed when the tax becomes effective.

THE TAXATION OF ALCOHOLIC BEVERAGES

Distilled Spirits Taxes

There are two distinct methods by which states derive revenue from distilled spirits.[41] In 16 states, called control or monopoly states, distilled spirits are sold at the retail or wholesale level by a state agency. The profits of selling operations provide these states with their major source of distilled spirits revenue. In North Carolina, distilled spirits are sold by the individual counties with the State levying an excise tax on county sales. In the remaining 33 states, called license states, private enterprise distributes distilled spirits at both the wholesale and retail level. In these states, the major source of state revenue from distilled spirits is derived from specific excise taxes levied on a gallonage basis. The current rate in Illinois is $1.52 per gallon, and is imposed on the privilege of manufacturing and importing alcoholic liquors.[42]

Since Illinois is a license state, and since methods of deriving state

[41] "Distilled Spirits comprise the categories of whiskey, gin, rum, brandy, neutral spirits, cordials or liqueurs, and other spirituous beverages as tequila, vodka, etc., made by a distillation process and usually containing at least 20 percent of alcohol by volume." *The ABC's of Alcoholic Beverages,* (New York: Licensed Beverage Industries, Inc.), p. 6.

[42] *Sixteenth Annual Report of the Department of Revenue,* Springfield, Illinois, 1959, p. 11.

revenue from distilled spirits are completely different in the license states from those in the monopoly or control states, no attempt will be made in this chapter to make an analysis of the monopoly system, or to compare the two systems.[43]

Distilled Spirits Tax Rates in the License States—General retail sales tax rates and levies other than specific excise taxes on distilled spirits are included in Table 7 because the consumption of liquor, and, consequently, state revenue derived from taxes levied on this product are dependent, among other things, upon these taxes. Even though a retail sales tax in a specific state may be general, in that it applies to all goods sold at the retail level, it may be avoided or evaded in the case of distilled spirits since the consumer might choose to travel to a neighboring state and purchase his liquor stock. High liquor prices resulting from high taxes may also result in an increase in the demand for illegally produced spirits. In other words, the demand for legally produced and distributed distilled spirits may very well be elastic with respect to price. A later section of this chapter will be devoted to the elasticity of demand for liquor, and the problem of tax evasion. This problem of tax evasion is far less severe in the case of cigarette taxation than it is in the case of distilled spirits taxation since few people will travel to a neighboring state to purchase a year's supply of cigarettes, and a market for illegally produced cigarettes seems non-existent in the United states today.

[43] Information pertaining to the monopoly system can be obtained by reference to: Twiley Wendell Barker, Jr., "State Liquor Monopolies in the United States" (unpublished Ph.D. dissertation, Dept. of Political Science, University of Illinois, 1955); and, Karl Baker Marx, "An Analysis of Some of the Factors That Determine the Variation in Per Capital Consumption and Per Capita State Distilled Spirits Revenue in States That Have a Monopoly on the Retail Distribution of Distilled Spirits," (Ph.D. dissertation, Dept. of Economics, University of Illinois, 1961), University of Michigan Microfilm, 1961.

TABLE 7

Distilled Spirits Tax Rates in the License States*
(September, 1960)

State	State Excise Tax Rate (Per Gallon)	Retail Sales Tax Rate (Percent)	Total Number of State Levies
Alaska	$3.50		1
Arizona	1.20	1 bar 2 pkg.	2
Arkansas†	2.50	3	5
California	1.50	3	2
Colorado	1.80‡		1
Connecticut	1.00	3.5	2
Delaware	1.15		1
Florida	2.17	3	2
Georgia§	1.00	3¶	3
Hawaii•		3.5	3

TABLE 7 (Continued)

State	State Excise Tax Rate (Per Gallon)	Retail Sales Tax Rate (Percent)	Total Number of State Levies
Illinois	1.52	3	2
Indiana**	2.00	0.375	4
Kansas††	1.00		2
Kentucky‡‡	1.28	2	4
Louisiana§§	1.68	2	3
Maryland	1.50	3	2
Massachusetts	2.25	0.3¶¶	2
Minnesota••	2.875		2
Missouri	0.80	2	2
Nebraska	1.20		1
Nevada	0.80	2	2
New Jersey	1.50		1
New Mexico***	1.30	2	3
New York	1.50		1
North Dakota†††	0.60		2
Oklahoma	2.40		1
Rhode Island	2.00	3	2
South Carolina‡‡‡	2.72§§§	3	4
South Dakota¶¶¶	0.75		2
Tennessee•••	2.00	3	3
Texas	1.68		1
Wisconsin	2.00		1

*SOURCE: Licensed Beverage Industries, Inc., New York. Excise tax rates were the same in 1959 as they were in 1960.
†3% specific retail sales tax on spirits, $0.20 wholesalers' case tax.
‡22½ cents per pint or fraction thereof.
§$2.25 warehouse tax per gallon.
¶On sales exclusive of Federal tax. Effective rate is about 1½%.
•3/10 of 1 percent general wholesale sales tax, 16 percent wholesalers' specific gross receipts tax.
**8 cents wholesalers' gallonage tax, ⅜ of 1% general wholesalers' sales tax.
††2½% specific retail sales tax on spirits.
‡‡5 cents wholesalers' case tax, 10 cents distillers' gallonage tax, 50 cents per $100 distillers ad valorem tax.
§§30 cents export case tax.
¶¶5% on meals (including drinks) over $1.00.
••13 cents to 25 cents wholesalers' case tax.
***1/8 of 1% general wholesale sales tax.
†††$1.90 wholesalers' gallonage tax.
‡‡‡$2.50 per case additional retail tax, $1.50 wholesalers' case tax.
§§§17 cents per half pint or fraction thereof.
¶¶¶10% wholesalers' specific gross receipts tax.
•••15 cents wholesalers' case tax.

In 1958, distilled spirits tax rates in only five of the license states were lower than the $1.02 per gallon tax levied in Illinois.[44] The average distilled spirits tax rate during that year was $1.65 per gallon, and the rates ranged from a low of 75 cents per gallon in South Dakota to a high of $3.25 per gallon in Georgia.[45] In 1959, the excise tax rate on distilled spirits in Illinois was increased to $1.52 per gallon, and has remained at that level to this date. Since there were no tax rate changes between 1959 and 1960, it can

[44] *Annual Statistical Review*, (Washington D.C.: The Distilled Spirits Institute, 1960), pp. 4-5.
[45] *Ibid.*, pp. 4-5.

be seen from Table 7 that the tax rate in Illinois during that period was not out of line with the tax rates in the other license states. During these two years the tax rates in 14 states were higher than the rate in Illinois. During 1961 tax rates were increased in four states. However, by the end of that year, tax rates in only 15 states were higher than the Illinois levy.

The state excise tax on distilled spirits in Illinois, as well as in most other license states, is not high in relation to the per unit taxes levied on cigarettes. The Illinois cigarette tax of four cents per package represents approximately 15 percent of the retail price. The Illinois excise tax on distilled spirits in 1959 represented about six percent of the retail price of a fifth of a typical "A" blend 86.8 proof whiskey.[46] However, when consideration is given to federal taxes, one may find that the drinking public is overtaxed in relation to the smoking public.

The Federal Government levies an excise tax on distilled spirits of \$10.50 per 100 proof (50 percent alcohol by volume) gallon. This tax alone accounts for \$1.82 of the retail price of a fifth of 86.8 proof whiskey. Table 8 and Table 9 were prepared by the Licensed Beverage Industries, Inc., and

TABLE 8

Tax Burden Per Fifth of 86.8 Proof Whiskey*
(29 Private-License States and D. C., 1960)

Federal Excise Tax	\$1.823
Rectification Tax	.052
Occupational Taxes	.014
Total Federal	\$1.889
State and Local Tax Burden	.570
(Weighted average, 29 Private-License States and D. C.	2.459
Average Retail Price	4.55
Tax Burden as a Percent of Retail Price	55%

*SOURCE: Prepared by the Licensed Beverage Industries, Inc., from data of the U.S. Treasury Department and the several states, October, 1961.

indicate that from 42.6 percent to 62.9 percent of the retail price of a fifth of a typical "A" blend whiskey is in the form of tax revenue to the various levels of government. In 1960, taxes accounted for 55 percent of the average retail price per fifth of 86.8 proof whiskey in 29 of the license states and the District of Columbia (see Table 8). Care must be taken in drawing conclusions from the data of Tables 8 and 9, since the rate structure itself is regressive, i.e. (the same per unit tax rate applies to the more expensive

[46] Assuming that the tax of \$1.52 per gallon applies to a tax gallon of 100 proof, conversion to 86.8 proof gallon gives a tax of \$1.32 per gallon, or 26.4 cents per fifth. The retail selling price of a fifth of typical "A" blend in 1959 was \$4.29 (price derived from Table 9). Dividing the tax per fifth by the price per fifth gives a tax rate of 6.2 percent. For the more expensive whiskeys the tax rate would be less than 6.2 percent.

TABLE 9

Tax Burden, By States, Per Fifth of 86.8 Proof Whiskey (1959)*

	Taxes Paid Per Fifth			
State	State (1)	State and Local (2)	State, Local and Federal† (3)	Total Tax Burden As Percent of Typical "A" Blend (4)
Alaska	$0.88	$0.88	$2.77	42.6
Arizona	.36	.39	2.28	47.5
Arkansas	.85	.87	2.76	55.5
California	.56	.63	2.52	51.5
Colorado	.37	.40	2.29	46.3
Connecticut	.47	.47	2.36	52.4
Delaware	.29	.29	2.18	47.9
D. of C.	.38	.38	2.27	50.4
Florida	.46	.52	2.41	49.2
Georgia	1.10	1.41	3.30	62.9
Illinois	.44	.53	2.42	56.4
Indiana	.64	.64	2.53	52.2
Kansas	.34	.36	2.25	48.5
Kentucky	.31	.37	2.26	47.6
Louisiana	.47	.54	2.43	51.2
Maryland	.43	.58	2.47	52.5
Massachusetts	.46	.52	2.41	49.7
Minnesota	.46	.82	2.72	56.1
Missouri	.30	.34	2.23	49.3
Nebraska	.25	.31	2.20	48.8
Nevada	.27	.35	2.24	49.2
New Jersey	.31	.38	2.27	47.4
New Mexico	.53	.76	2.65	54.6
New York	.45	.54	2.43	50.7
North Dakota	.52	.87	2.76	55.8
Rhode Island	.55	.66	2.55	53.7
South Carolina	.74	.74	2.63	50.6‡
South Dakota	.60	.72	2.61	51.2
Tennessee	.55	.62	2.51	52.3
Texas	.35	.37	2.26	55.8
Wisconsin	.43	.46	2.35	54.8

*Tax burden on product and privilege of sales includes excise tax, sales tax, license fees and other misc. taxes on distilled spirits paid by consumers in the various states except as indicated in (‡). SOURCE: Prepared by the Licensed Beverage Industries, Inc., 1960.
†Total includes federal tax burden of $1.89 per gallon in each state.
‡Excludes South Carolina case tax of $1.50 per case at wholesale and $2.50 at retail absorbed by dealers. If these levies were included in the burden, the figures would be as follows:

Federal	State	State & Local	Grand Total	%
$1.89	$1.00	$1.00	$2.89	55.6

86.8 proof whiskeys as applies to the lower priced 86.8 whiskeys, which means that the excise tax represents a higher percentage of the price of lower priced whiskey than it does of higher priced whiskey).[47] This reduction in the tax burden on the more expensive types and brands of whiskey probably does not exceed five or ten percent when all taxes, including state and local ad valorem retail sales taxes are considered. However, it does seem reasonable to conclude that 50 percent or more of the final retail price of distilled spirits purchased by people in the lower income brackets goes to the various levels of government in the form of tax revenue or license fees. An additional factor that must be considered is that the tax burden is lower on those people who purchase their whiskey by the drink than on those who purchase their whiskey by the bottle.[48]

Tax rates alone do not explain the variation in retail prices among the various license states. The price in each state can be found by dividing column (3) Table 9 by column (4) Table 9. For example, in Illinois, the total tax burden of $2.42 represented 56.4 percent of the retail price. Dividing $2.42 by 56.4 percent gives a price of $4.29 per fifth. In Florida, the tax of $2.41 accounted for 49.2 percent of the retail price of $4.90 per fifth. Total taxes per fifth were practically the same in both Illinois and Florida, but the retail price was 61 cents per fifth higher in Florida than it was in Illinois.[49] It appears that a greater share of the total tax was shifted to the consumer in Florida than was shifted in Illinois. If the demand for distilled spirits is more inelastic in Florida than it is in Illinois, and it certainly may be because of the vast amount of tourist trade in the state of Florida, a greater share of the tax can be shifted forward to the consumer in Florida than in Illinois. The variation in the degree of retail competition between the two states might also help explain why the price was higher in one state than in the other.

Comparison of State Distilled Spirits Revenue—Revenue and tax rate data for those states where it was possible to distinguish between state excise revenue resulting from excise taxes levied on distilled spirits and that revenue resulting from excise taxes levied on wine are included in Table 10. To determine if a significant relationship existed between the variation in excise tax rates and the variation in per capita distilled spirits revenue derived from these taxes, the data from Table 10 were plotted on Figure 2. A

[47] This same regressive rate structure applies also to the more expensive 100 proof whiskeys. In 1960, Old Forester, 100 proof bottled in bond whiskey sold for $6.60 in Illinois (SOURCE: The Licensed Beverage Industries, Inc.). With a tax rate of $1.52 per gallon, the rate per fifth was 30.4 cents, which is 4.6 percent of the retail price. For the less expensive 86.8 proof whiskey the rate per fifth was 6.2 percent (see footnote 46).

[48] Assume that the retail selling price per fifth of a specific brand whiskey is $4.50 before retail sales taxes are levied. Assume also that the retail sales tax rate is 4 percent, the federal tax is $1.889 per fifth, and the state excise tax is 24 cents per fifth. The total tax per fifth purchased at a package store is then: $1.889 plus $0.24 plus $0.18, or $2.309, which is approximately *50 percent* of the final selling price of $4.68. Assume that there are 25 one-ounce drinks per fifth, and that the price of each drink is 35 cents (the higher the price per drink, the lower will be the tax rate). The total tax paid by the consumer who purchases this fifth by the drink is then: $1.889 plus $0.24, plus $0.25, or $2.379, which is approximately *26 percent* of the final selling price of $9.00. State and local license fees would tend to reduce this spread somewhat. However, the spread would be even greater if the sales tax did not apply to drinks sold over the bar.

[49] Retail price data supplied by the Licensed Beverage Industries indicate that prices of other types of liquor were also higher in Florida than in Illinois.

TABLE 10

Comparison of State Excise Tax Rates and State Excise Tax Revenue (1960)*

State	Gross Distilled Spirits Revenue (000) (1)	Per Capita Distilled Spirits Revenue (2)	Excise Tax Rates (3)
Arizona	$ 1,629	$1.25	$1.20
Arkansas	3,616	2.02	2.50
California	41,184	2.62	1.50
Colorado	4,664	2.66	1.80
Connecticut	5,673	2.24	1.00
Delaware	966	2.17	1.15
Florida	20,163	4.07	2.17
Georgia	3,094	.78	3.25
Illinois	23,441	2.33	1.52
Indiana	7,159	1.54	2.08
Louisiana	5,803	1.78	1.68
Massachusetts	19,552	3.80	2.25
Nebraska	1,840	1.30	1.20
Nevada	866	3.09	.80
New Jersey	17,205	2.84	1.50
New Mexico	1,161	1.22	1.30
New York	45,297	2.70	1.50
Oklahoma	4,412	1.90	2.40
South Carolina	6,090	2.56	2.72
Tennessee	4,695	1.32	2.00
Texas	14,142	1.48	1.68

*Column (1) derived from: *Public Revenues From Alcoholic Beverages*, (Washington D.C.: The Distilled Spirits Institute, 1960). Population figures used in computing column (2), April 1, 1960, SOURCE: *Op. cit., Compendium*, p. 56.

linear regression curve (Y_1) was drawn, but the resulting correlation coefficient of .3163 indicates that the variation in excise tax rates was not a statistically significant factor in determining the variation in per capita state distilled spirits revenue during 1960.[50] Since per capita distilled spirits revenue in Alaska was so far out of line with per capita distilled spirits revenue in the other states, it was decided to eliminate Alaska from the population. A new linear regression curve (Y_2) was computed and drawn, but the resulting correlation coefficient of $-.0657$ indicates that, even without Alaska, no significant relationship existed between these two variables.[51] A simple regression was run between the variation in per capita personal income and the variation in per capita state distilled spirits excise tax reve-

[50] The critical value of r at the one percent level of significance with 22 observations is .537. See, *Op. cit., Ferber*, p. 520.

[51] The critical value of r at the one percent level of significance with 21 observations is .549. See, *Op. cit., Ferber*, p. 520.

nue in 1960, but the resulting correlation coefficient of .4509 indicated that no significant relationship existed between these two variables.[52]

In an attempt to determine if a combination of the variation in tax rates and the variation in per capita personal income would explain the variation in per capita state distilled spirits excise tax revenue, a three variable multiple correlation test was run in which the variation in per capita income and the variation in excise tax rates were independent variables and the variation in per capita state distilled spirits excise tax revenue was the dependent variable. The multiple correlation coefficient obtained was .5462, which is not significant at the one percent level.[53] Several reasons for the lack of correlation between excise tax rates and per capita excise tax revenue have been outlined earlier. Other taxes, such as retail sales taxes, wholesalers' case or sales taxes, and even, to some extent, license fees, influence the final price of the product, and, consequently, the amount of the product purchased.[54] Two other factors that influence consumption of distilled spirits, and, consequently, per capita distilled spirits excise tax revenue are the percentage of the population of a state that live in areas in which it is legal to sell distilled spirits, and the number of people per retail outlet.[55]

Elasticity of Demand for Distilled Spirits—The success of a tax rate increase depends upon the elasticity of demand for the product in question. If the demand for a product is relatively inelastic, as in the case of cigarettes, an increase in the tax rate should result in a considerable increase in state tax revenue. However, if the demand for a product is relatively elastic, a tax rate increase will result in a proportionately larger reduction in sales, and may well result in only a meager increase in state revenue. The producer or distributor of the product may suffer since his sales decline, and he must also absorb a large share of the tax burden.[56]

Several students of liquor taxation have concluded that the demand for this product is relatively inelastic. In 1942, Glenn D. Morrow and Orba F. Traylor assumed that the demand for alcoholic beverages is inelastic when

---

[52] *Ibid.*, p. 520.

[53] With 21 observations and 3 variables, the critical value of R at the one percent level of significance is .620. See: Ferber, p. 520.

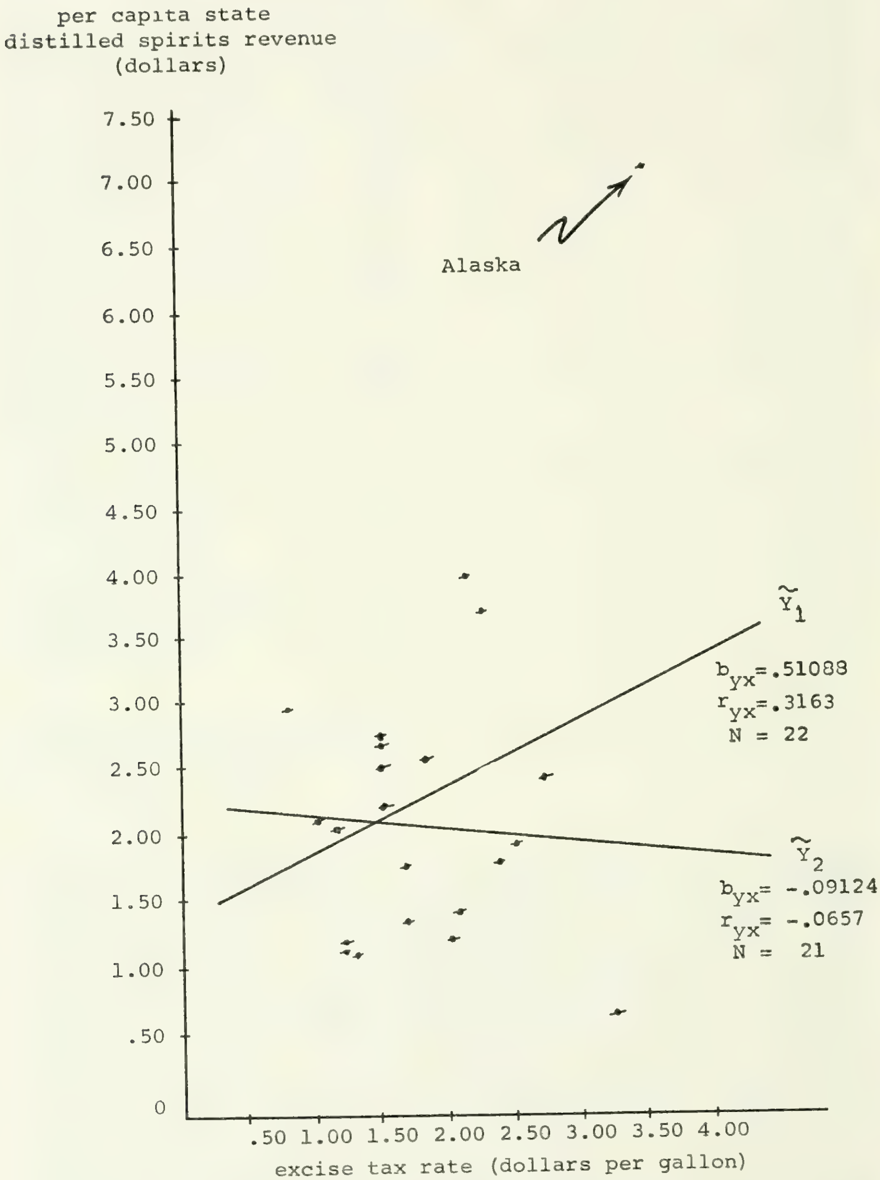
[54] A recent study indicates that in the monopoly states during 1956, the variation in average whiskey prices accounted for approximately 57 percent of the total variation in per capita consumption of distilled spirits in areas in which it was legal to sell distilled spirits (N equals 15, r equals minus .7578). See: *Op. cit.*, Marx, pp. 14-17.

[55] In this same study, using the same 15 monopoly states, a multiple correlation coefficient of .8359 was obtained when a multiple correlation test was run in which the variation in average retail whiskey prices and the variation in wet population per retail outlet were independent variables, and the variation in per capita consumption in wet areas (areas in which it is legal to sell distilled spirits) was the dependent variable. The coefficient of determination was .6989. Other variables, such as the variation in per capita income, the variation in the percentage of the population urban, and the variation in the percentage of the population of voting age or more, were not significant factors in determining the variation in per capita consumption in wet areas. See: *Op. cit.*, Marx, Chapter III.

[56] It is possible that the producer may not be able to directly shift the tax backwards to the owners of the factors of production in the long run if these factors can shift from the taxed industry to other industries. However, this shift in factors of production will tend to reduce not only the wage rates of the moving factors, but also, because of the increased supply of factors, the wage rates of factors already employed in other industries. To the extent that this is possible, some of the tax can be shifted indirectly to the factors of production employed in non-taxed industries. If labor unions in both the taxed industry and the non-taxed industries have considerable monopoly power, unemployment, rather than a general reduction in factor payments, may occur. Under these conditions, it is possible that a disproportionate share of the tax may be shifted to owners of the other factors of production.

FIGURE 2

Comparison of State Excise Tax Rates
and State Excise Tax Revenue 1960



they wrote: "Tax levies within current limitations apparently exercise little influence on consumption of legal alcoholic beverages."[57] In the 1949 *Report of the Revenue Laws Commission,* Dr. J. D. Morgan wrote:

> The sections on consumption and elasticity indicate that the demand for alcoholic beverages is quite inelastic. . . . It would appear that within any reasonable limit, the state can secure what revenue it wishes from the liquor tax by the simple expedient of making proportionate changes in its tax rates. If Illinois wanted an additional twelve million dollars from distilled spirits, all she would have to do would be to double her present $1 tax.[58]

Tax rates on distilled spirits were not increased in Illinois at that time. However, on August 1, 1959, the excise tax rate on distilled spirits was increased from $1.02 per gallon to $1.52 per gallon. According to retail price data supplied by the Licensed Beverage Industries, the resulting increase in retail prices was greater than the increase in the tax.[59] Retail prices in almost all other states were the same in 1960 as they were in 1959.[60] Between 1959 and 1960, consumption of distilled spirits increased by 10.1 percent in Illinois, while the average increase in consumption in the license states was 4.9 percent.[61] Per capita consumption of distilled spirits in Illinois increased from 1.43 gallons in 1959, to 1.60 gallons in 1960, to 1.63 gallons in 1961,[62] which means that in Illinois, consumption of distilled spirits is increasing at a faster rate than the increase in population. Since, in 1960, consumption increased while prices were increasing by more than the tax increase, it is safe to conclude that most, if not all, of the additional tax burden was, at least in the short run, shifted to the drinking public. State revenue derived from the excise tax on distilled spirits increased from $16 million in 1959 to over $23 million in 1960. Monthly data on distilled spirits collections, supplied by the Illinois Department of Revenue, indicate that revenue from this source will exceed the 1960 level in both 1961 and 1962.

This all seems to substantiate Dr. Morgan's claim that the demand for distilled spirits in the State of Illinois is quite inelastic. However, under "normal" conditions, a price increase will lead to a reduction in the consumption of a specific product. If, both the price of the product, and the amount of the product sold increase at the same time, the demand for the product in question must have increased. Since the percentage increase in per capita personal income was less in Illinois than the national average between 1959 and 1960, the reasons for this shift in demand for distilled spirits are not apparent to this writer at this time. No definite conclusions regarding the elasticity of demand for distilled spirits in Illinois can be made

---

[57] Glenn D. Morrow, and Orba F. Traylor, *State Liquor Monopoly or Private Licensing?,* (The Legislative Council: Commonwealth of Kentucky, 1942), p. 62.

[58] J. D. Morgan, "Taxation of Alcoholic Beverages," *Report of the Revenue Laws Commission,* (Springfield, Illinois: State of Illinois, 1949), p. 564.

[59] The price per fifth of Seagrams 7 Crown blended whiskey increased by 10 cents, while the price of Old Forester increased by 21 cents per fifth. SOURCE: "Retail Sales Prices of Leading Brands," Licensed Beverage Industries, Inc.

[60] *Ibid.*

[61] *Apparent Consumption of Distilled Spirits,* 1952-1961, (Washington D.C.: The Distilled Spirits Institute, 1962).

[62] *Ibid.*

without full knowledge of the extent of the increase in demand for this product.

Other students of distilled spirits taxation have claimed that the demand for this product is relatively elastic. Joseph McKenna and Francis Boddy wrote in a paper read before the Forty-sixth Annual Conference of Taxation of the National Tax Association, "Most investigators agree that the best estimate of elasticity for distilled spirits is between 1.0 and 1.5."[63]

In reference to an earlier study the authors wrote, "The most recent study, done for the industry by independent economists, leans toward the high side, near 1.5."[64] McKenna and Boddy felt that that estimate was high. They wrote, "The authors lean toward an estimate in the lower end of this range, say, under 1.2."[65]

In an annual publication, the Licensed Beverage Industries, Inc., include a section on the unsuccessful attempts of states to increase tax revenue by increasing tax rates on distilled spirits.[66] However, based on their data, it is impossible to make generalizations regarding the elasticity of demand for distilled spirits. Referring to Rhode Island, the report reads, " . . . the liquor levy was increased from $1.00 to $1.50 in 1951. Sales declined 49% in the first full year of the higher tax (against a decline of 12% for the nation as a whole) ; revenue fell off by 23.5%. Sales in the succeeding year were still 32% below those under the old levy; revenues up only 1.7% from those realized under the old rate."[67] This writer does not question the implication that the demand for distilled spirits in Rhode Island is relatively elastic since it is quite easy to travel to Connecticut or other neighboring states to purchase a stock of liquor. However, the authors of the study must agree that the demand for distilled spirits in West Virginia, a control state, was probably inelastic when they wrote, "West Virginia . . . raised its gross markup on a typical bottle by about 1/3 in mid-1957. In fiscal 1960, sales were still 9.3% below those of fiscal 1957—while gallonage sales for the nation as a whole had risen 6.2%."[68] In other words, if the price increased by 33 percent and sales fell by only 9.3 percent (about 15 percent if consideration is given to the national increase), the demand for distilled spirits in that state was inelastic.[69]

Since the retail price per fifth is determined by a state agency in the control states, closer estimates of price elasticity of demand, based on price and consumption data, can be made in these states than in the license states. In December of 1959 an additional tax was levied on distilled spirits in Alabama, which resulted in a retail price increase of slightly less than 10

[63] Joseph P. McKenna, and Francis M. Boddy, "How Bad are Liquor Taxes?", *Proceedings of the National Tax Association*, (Paper read before the Forty-sixty Annual Conference of Taxation of the National Tax Association, at Louisville, Kentucky, September 28, 1953), p. 31.

[64] *Ibid.*, p. 33.

[65] *Ibid.*, p. 33.

[66] *Facts About the Licensed Beverage Industry*, (New York: Licensed Beverage Industries, Inc., 1961).

[67] *Ibid.*, p. 45.

[68] *Ibid.*, p. 45.

[69] Gallonage sales were 1,731,000 in 1957 and 1,579,000 in 1958, which represents an 8.8 percent reduction in consumption. SOURCE: *Op. cit., Apparent Consumption.*

percent.[70] In 1960, consumption of distilled spirits in that state was 7.7 percent lower than it was in 1959.[71] On April 1, 1959, liquor prices in Ohio were increased by approximately 10 percent. Consumption in Ohio dropped from 11,776,000 gallons in 1958 to 11,415,000 gallons in 1959, to 11,112,000 gallons in 1960, which was a decrease of 3.1 percent from 1958 to 1959, and a decrease of 2.7 percent from 1959 to 1960.[72] A tax increase in Washington on April 1, 1959, resulted in a price increase of slightly over 4 percent per fifth of distilled spirits.[73] Consumption in that state increased by 7.4 percent from 1958 to 1959, and by 3.9 percent from 1959 to 1960.[74] Based on these data, and the fact that the average increase in apparent consumption of distilled spirits in the United States was 4.1 percent between 1959 and 1960,[75] it appears that the demand for distilled spirits in Alabama was slightly elastic, but that the demand for distilled spirits was relatively inelastic in Ohio. No definite conclusions can be based on the data presented in this section since many determinants of changes in consumption, such as population changes, and changes in income and employment were not taken into consideration.

Even though, in an earlier study, this writer agreed with McKenna and Boddy that the demand for distilled spirits is relatively elastic, the evidence available does not appear to support this, or any other claim with respect to price elasticity of demand for distilled spirits. However, it does seem quite apparent that price elasticity of demand for liquor varies from state to state. The demand for distilled spirits may be elastic in certain states, and quite inelastic in other states.

One of the major determinants of price elasticity of demand is the availability of good substitutes for a specific product. In some areas of the country, beer and wine may be satisfactory substitutes for distilled spirits. For some people, regardless of the area of the country, beer and wine are not substitutes for distilled spirits. For some of these individuals, distilled spirits sold in neighboring states may be the only good substitute, while for still others, "moonshine," an illicitly distilled liquor, becomes a good substitute if prices on the legal product are increased. Whether a person switches to beer, wine, "moonshine," or a product sold in a neighboring state, or country, as the case might be, when domestic liquor prices are increased depends upon many factors, such as the individual's income, geographical location, culture and tradition, and even law enforcement. Cultural and geographical factors are probably the main determinants of substitutability for legally distributed distilled spirits. These cultural and geographical patterns vary from state to state, therefore, price elasticity of demand for distilled spirits should also vary from state to state.

---

[70] Price data supplied by the Licensed Beverage Industries.
[71] *Op. cit., Annual Statistical Review,* p. 39.
[72] *Op. cit., Apparent Consumption.*
[73] Price data supplied by the Licensed Beverage Industries.
[74] *Op. cit., Apparent Consumption.* (per capita consumption in Washington was 1.17 gallons in 1958, 1.24 gallons in 1959, and 1.27 gallons in 1960. SOURCE: *Apparent Consumption.*)
[75] *Op. cit., Annual Statistical Review,* p. 39.

Tax Evasion[76]—In 1938 Albert Abrahmson wrote, "The extent of evasion is of course not known, estimates vary. Some say that one-fourth to one-half of the liquor produced is illegal. Whatever the exact proportion, no one doubts that the Bootlegger's business is large."[77] The Licensed Beverage Industries, Inc. make a yearly comprehensive survey on illegal distilling activities based on reports from Federal, state, and local law enforcement agencies.[78] In its 1960 report the Licensed Beverage Industries summarized the illegal activities of the past decade. The report reads:

> From 1950-to-1960
>
> Moonshine production has averaged 61 million gallons a year. This is nearly one-fifth of the apparent consumption of distilled spirits in the U.S. during the same 10 years.
>
> The tax loss of Federal, state and local governments on this sea of moonshine amounted to an estimated $7 billion for the decade.
>
> Dedicated law enforcement agents seized nearly 214,000 illegal stills during the 1950's, but still could not shut off the flood of moonshine.
>
> Tragedy, too, marked the "moonshine decade." More than one hundred and fifty Americans are known to have died of poison moonshine and hundreds more were hospitalized—some to go home blinded or crippled.[79]

The report went on to say that most production occurred in the South and Northeast, but that in 1959 some production or sale of "moonshine" was reported in 39 of the 48 states.[80] Even though there are fewer stills seized in the Northeastern states than in the Southern states, "those detected are often huge industrial sized stills with daily capacities of 500-to-1,000 gallons of moonshine."[81] In summarizing the changes that have occurred in the illegal distilling industry, the Licensed Beverage Industries said: "Moonshining, once the hobby of hill-billies, today is a billion dollar racket, managed by America's most malignant crime syndicates."[82] According to the report, in 1959, approximately 25,000,000 gallons of "moonshine" were produced by stills that had been seized.[83] They conclude that: "Assuming conservatively, as do most enforcement officers, that at least one still continued in operation for each one seized during the year, total illicit output for 1959 came to at least 50,000,000 gallons.[84]

Table 11, in which 1959 prices of "moonshine" and legal spirits are compared, was reproduced from the Licensed Beverage Industries' report. The table indicates that, in general, there is a wide price spread between "moonshine" and legally produced liquor.

According to the report, during 1958 and 1959, "7 key moonshine pro-

---

[76] This section on tax evasion was taken from; *Op. cit.*, Marx, pp. 39-43.
[77] Albert Abrahmson, "Whiskey—The Incidence of Public Tolerance in Price Policy," *Prices and Price Policies*, ed. W. H. Hamilton, (New York: McGraw-Hill Book Company, Inc., 1938), p. 427.
[78] *Operation Moonshine*, (New York: Licensed Beverage Industries, Inc., 1960).
[79] *Ibid.*, p. 3.
[80] *Ibid.*, p. 3.
[81] *Ibid.*, p. 10.
[82] *Ibid.*, p. 12.
[83] *Ibid.*, p. 21.
[84] *Ibid.*, p. 21.

TABLE 11

Comparative Prices of Moonshine and Legal Spirits*

State	Moonshine, Per Pint	Legal Liquor, Per Pint 1/
Alabama†	$1.50	$2.95
Arkansas	1.50-2.00	3.32
Delaware	1.50	2.85
Florida	1.20	3.10
Georgia	1.50-2.00	3.30
Kansas	2.00	2.50
Kentucky	2.50	3.03
Indiana	2.00	3.00
Maryland	2.50	2.98
Ohio†	2.50	2.65
North Carolina†	2.00	2.50
Oklahoma	2.00	2.95-3.15
Pennsylvania†	2.00	2.89-3.00
South Carolina	2.00	3.05
Tennessee	2.00	3.09
Virginia†	1.50	2.50

1/—86 proof, A blend.

**Operation Moonshine,* (New York: Licensed Beverage Industries, Inc., 1960), p. 30.
†Monopoly states.

ducing or importing states have raised liquor taxes or markups . . ."[85] The effect of these increases is shown in Table 12, which is also taken from a portion of a table appearing in the report. The report concludes that: "These additions to legal prices may be presumed generally to have the effect of stimulating sales of illegal liquor by widening the gap between moonshine and legal prices."[86]

Should Distilled Spirits Tax Rates Be Increased?—If the demand for distilled spirits is as inelastic as Dr. Morgan suggests,[87] a 50 cent per gallon increase in excise tax rates should result in approximately $7.5 million additional revenue annually from this source. However, this writer does not believe that the demand for distilled spirits is as inelastic as Dr. Morgan implies, and estimates that, assuming no major changes in economic activity or population, an increase of 50 cents in the distilled spirits excise tax will result in not more than a $4 million increase annually in excise tax revenue from this source. Distilled spirits excise tax revenue lost because of the reduced liquor consumption will be partially recovered to the extent that some people may substitute beer or wine for liquor. However, State and local retail sales tax collections from the sales of distilled spirits will decline

[85] *Ibid.*, p. 31.
[86] *Ibid.*, p. 31.
[87] *Supra*, pp. 45-46.

TABLE 12

Moonshiners' Margins Rise Sharply As Even Moonshine States Raise Liquor Taxes and Markups*

State	Tax or Markup Increase	Old	Change in Legal Pint Price New	Increase	Increase in Moonshine Margin (Gal.)
Alabama†	3% gen. retail sales tax and 10% special retail sales tax. tax.	$2.65	$2.95	$+.30	$+2.40
Kentucky	3% gen. retail sales tax.	2.95	3.03	+.08	+ .64
Michigan†	8% retail sales tax.	2.55	2.75	+.20	+1.60
Ohio†	Markup increase and 3% gen. retail sales tax.	2.31	2.64	+.33	+2.64
Tennessee	3% gen. retail sales tax.	3.00	3.09	+.09	+ .72
Virginia†	10% retail sales tax.	2.25	2.50	+.25	+2.00
West Virginia†	10 cents per bottle.	2.60	2.70	+.10	+ .80

Operation Moonshine, (New York: Licensed Beverage Industries, Inc., 1960), p. 30.
†Monopoly states.

to the extent that some people may purchase their liquor stocks in neighboring states, or switch to "moonshine."

As indicated above, over 56 percent of the final retail price per fifth of a typical "A" blend whiskey in Illinois is in the form of tax revenue to some level of government. (See Table 9). It was also shown that the tax increase of 1959 was shifted forward to the consumer.[88] An excise tax of $2.02 per gallon levied on distilled spirits will mean that the consumer of this product will pay approximately 60 percent of the final price per fifth of liquor to government.

Since the consumer of distilled spirits already bears a disproportionate share of the burden of government expenditures merely because he chooses to consume this product, it is recommended that the excise tax rate on distilled spirits should not be increased at this time. It is further recommended that serious consideration be given to either lowering the $1.52 per gallon state excise tax rate levied upon distilled spirits, or exerting pressures on the United States Congress to reduce the $10.50 per gallon "temporary" Federal levy on this product.

A tax reduction on the part of the Federal Government will not only reduce the tax burden of the drinking public, but it should also result in

[88] *Supra*, p. 46.

increased state excise tax collections from distilled spirits to the extent that consumption of this product will increase due to the lower price. Whether or not this increase in consumption of distilled spirits is desirable depends upon the value judgments of society. However, if the social goal is low consumption of liquor, a more equitable method than high liquor taxes can be devised to attain this goal.

Beer Taxes

State Beer Tax Rates and Revenue—Of the 41 states for which complete information on beer consumption and revenue was available for 1960, Illinois ranked 4th in consumption, 6th in total excise tax revenue, 9th in per capita consumption, but only 20th in per capita revenue collected from specific excise taxes levied on beer. This low per capita state beer revenue in Illinois appears to be a result of the low excise tax rate which applies to beer. The excise tax rates levied on beer in 27 of the 41 states were higher than the 13.5 cent per case of twenty-four 12-ounce containers (6 cents per gallon) rate levied in Illinois.

TABLE 13

Beer Consumption, State Revenue, and Tax Rates (1960)*

State	Consumption In Gallons (000) (1)	Excise Tax Revenue (000) (2)	Per Capita Consumption In Gallons (3)	Per Capita Excise Tax Revenue (4)	Tax Rate Per Case Of 24 12-Ounce Containers (5)
Alabama	16,900	$ 3,370	5.17	$1.03	$0.480
Alaska	2,900	638	12.83	2.82	.562
Arizona	21,000	1,545	16.13	1.19	.169
Arkansas	11,600	1,763	6.49	.99	.352
California	232,400	9,069	14.79	.58	.090
Colorado	23,900	1,421	13.63	.81	.135
Connecticut	39,600	1,309	15.62	.52	.073
Delaware	7,100	470	15.92	1.05	.145
Florida	65,800	19,884	13.29	4.02	.720
Georgia	21,600	8,284	5.48	2.10	.960
Idaho	8,300	844	12.44	1.27	.225
Illinois	189,000	11,337	18.75	1.12	.135
Indiana	70,100	3,639	15.04	.78	.180
Iowa	40,200	3,198	14.58	1.16	.180
Kentucky	36,400	2,217	11.98	.73	.181
Louisiana	41,800	13,270	12.83	4.07	.726
Maine	14,400	2,210	14.86	2.28	.360
Maryland	61,100	1,805	19.70	.58	.068
Massachusetts	81,400	5,256	15.81	1.02	.145
Michigan	161,500	10,523	20.64	1.35	.181

TABLE 13 (Continued)

State	Consumption In Gallons (000) (1)	Excise Tax Revenue (000) (2)	Per Capita Consumption In Gallons (3)	Per Capita Excise Tax Revenue (4)	Tax Rate Per Case Of 24 12-Ounce Containers (5)
Minnesota	54,600	4,249	15.99	1.24	.232†
Missouri	69,100	1,359	16.00	.31	.045
Montana	12,900	602	19.11	.89	.109
Nebraska	23,700	938	16.80	.66	.090
Nevada	6,900	210	24.21	.73	.068
New Hampshire	11,300	1,103	18.62	1.82	.218
New Jersey	117,600	3,921	19.38	.65	.075
New Mexico	11,700	605	12.30	.64	.120
New York	317,100	10,626	18.90	.63	.075
North Carolina	24,400	7,898	5.36	1.73	.840
Ohio	169,800	24,409	17.49	2.51	.360
Oklahoma	19,600	6,350	8.42	2.73	.726
Oregon	24,800	1,040	14.02	.59	.094
Pennsylvania	215,800	19,404	19.07	1.71	.240
South Carolina	13,000	5,732	5.46	2.41	1.440
Tennessee	27,100	2,952	7.60	.83	.247
Texas	139,500	19,013	14.56	1.98	.312
Utah	7,400	254	8.31	.29	.290
Virginia	41,800	9,075	10.54	2.29	.600
West Virginia	17,700	3,292	9.52	1.77	.399
Wisconsin	101,300	3,265	25.63	.83	.073

*SOURCES: Data for column (1) supplied by U.S. Internal Revenue Service; data for column (2) supplied by, *Op cit., Public Revenues,* (DSI); data for column (5) supplied by, *Op. cit., Facts and Figures,* pp. 192-193. Population figures used in computing columns (3) and (4), April 1, 1960, *Op. cit., Compendium,* p. 56.
†Beer not over 3.2% taxed at 11.6 cents per case.
SOURCE: *Facts and Figures, op. cit,* p. 193.

It can be seen from Table 13 that both total and per capita consumption of beer in the Southern states are quite low in relation to beer consumption in the other states. There appears to be no direct relationship between tax rates and per capita revenue in these Southern states. In Alabama, Arkansas, and Tennessee, relatively high tax rates were accompanied by relatively low levels of per capita state beer revenue. Florida, South Carolina, and Virginia had both high tax rates (72 cents, $1.44, and 60 cents respectively) and high levels of per capita revenue ($4.02, $2.41, and $2.29 respectively). However, excluding the Southern states, there appears to be a positive relationship between excise tax rates and per capita state beer revenue.

Per capita state beer revenue and beer excise tax rates for the states located in the Northeastern quarter of the United States are included in Table 14 to show the relationship between tax rates and per capita revenue

TABLE 14

Per Capita Beer Revenue and Tax Rates (1960)*

State	Per Capita Beer Revenue	Tax Rate Per Case of 24 12-Ounce Containers
Ohio	$2.51	$0.360
Maine	2.28	.360
New Hampshire	1.82	.218
Pennsylvania	1.71	.240
Michigan	1.35	.181
Minnesota	1.24	.232†
Iowa	1.16	.180
Illinois	1.12	.135
Delaware	1.05	.145
Massachusetts	1.02	.145
Wisconsin	.83	.073
Indiana	.78	.180
New Jersey	.65	.075
New York	.63	.075
Maryland	.58	.068
Connecticut	.52	.073
Missouri	.31	.045

*SOURCE: Table 13.
†Beer not over 3.2% taxed at $0.11.6 cents per case.

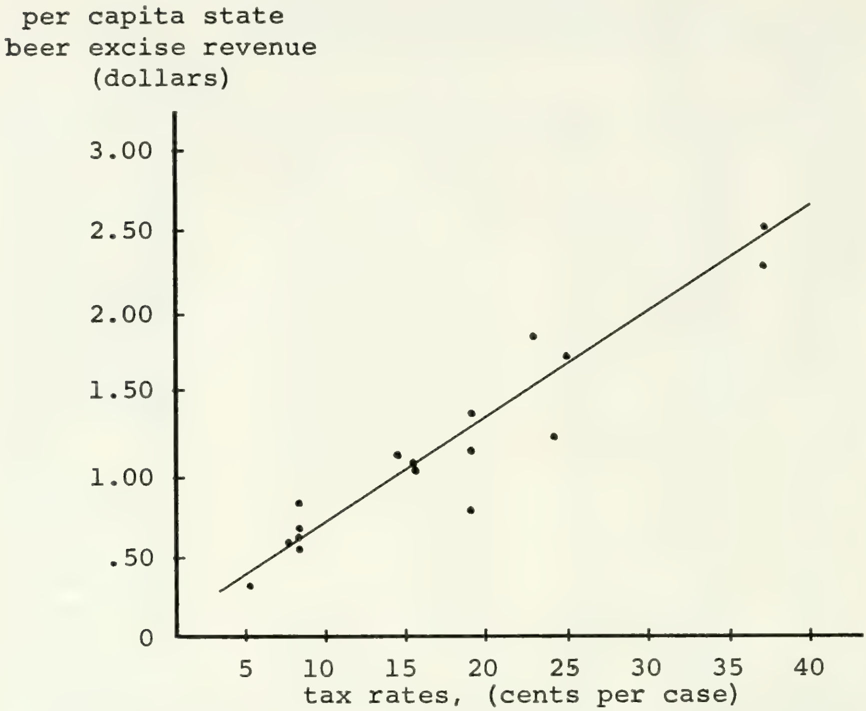
in these states. Ohio and Maine, with the highest excise tax rates in 1960, also had the highest levels of per capita excise tax revenues during that year.

Data from Table 14 have been plotted on Figure 3, and a linear regression line was drawn free hand. This regression line indicates that one would expect that per capita state beer revenue would increase by approximately 33 cents for each 5 cent increase in the tax rate per case of twenty-four 12-ounce containers of beer. The excise tax rate on beer in Illinois was increased from nine cents per case to 13.5 cents per case on August 1, 1959. This increase of 4.5 cents per case resulted in an increase in per capita state beer revenue of 39.9 cents.[89] Based on an estimated population of 10.7 million people in Illinois during 1964, a 10 cent per case increase in the State's excise tax rate on beer should result in a $7 million increase in excise tax revenue from this source. The new excise tax rate on beer would be 23.5 cents per case, or approximately one cent per bottle. Assuming that Illinois is the only state to increase its excise tax rate applying to beer between now and 1964, 15 of the 41 states included in Table 13 will still have rates higher than the 23.5 cents per case rate levied in Illinois.

[89] This 39.9 cent increase assumed a population of 10,081,000, beer excise tax collections of $7,308,000 in 1959 (Illinois Department of Revenue), and $11,337,000 in 1960 (*Op. cit., Public Revenues*, p. 26). Part of this tax increase was a result of an inventory floor tax.

FIGURE 3

Per Capita Beer Revenue and Tax Rates (1960)



Should Excise Tax Rates on Beer be Increased?—The Federal excise tax levied on beer is $9.00 per barrel, which is approximately 29 cents per gallon, or 65.3 cents per case of twenty-four 12-ounce containers. Therefore, with the 13.5 cent per case excise tax rate levied in Illinois, the combined Federal and State tax levied on beer in that State is 78.8 cents per case. On July 20, 1962, the final retail price of a case of "premium" beer purchased in a city located in the western part of Illinois was $4.75. This price included State and local retail sales taxes.[90] Therefore, assuming a total sales tax rate of 4 percent, the combined Federal and State excise taxes plus State and local sales taxes were 97.1 cents per case, or 20.4 percent of the final retail selling price. On this same date, a case of "popular" beer sold for $3.50. State and local sales taxes accounted for about 13.5 cents of this price. Thus, the total tax on the lower priced "popular" beer was 92.3 cents per case, or 26.3 percent of the final retail selling price.

If the excise tax rate on beer in Illinois should be increased by 10 cents per case, assuming that the additional tax would be shifted forward to the consumer, the price of "premium" beer would be about $4.85 per case. This price includes the combined Federal, State, and local tax of approximately

[90] The retail prices quoted in this section did not prevail at all retail outlets on that specific date. However, a lower retail price per case does not necessarily mean a higher tax rate, but may indicate that a smaller portion of the tax is being shifted forward to the consumer.

$1.08 per case, which is 28.6 percent of the final selling price. In other words, a 10 cent increase in the excise tax rate will increase the tax burden by 2.5 percent of the retail price, which means that the individual who chooses to allocate part of his income to beer consumption will be paying proportionately half the tax paid by consumers of cigarettes and distilled spirits.

It is recommended that, if a more equitable tax system can not be adopted in Illinois, the excise tax on beer should be increased by approximately 10 cents per case of twenty-four 12-ounce containers.

Wine Taxes

State Wine Tax Rates and Revenue—Of the 31 license states that levied per unit excise taxes on wine in 1960, Illinois ranked third in total wine consumption, second in state revenue collected from excises on wine, and third in per capita excise revenue from this source.[91] During that same year, the excise tax rates on wine, having an alcohol content of from 14 to 21 percent, in only six states were higher than the 60 cents per gallon rate levied in Illinois.[92] Florida was the only one of these six states in which per capita revenue derived from excise taxes levied on wine was higher than per capita revenue derived from this source in Illinois.

A direct relationship, such as the one that appeared to exist between excise tax rates on beer and per capita state beer revenue in those states located in the Northeastern quarter of the United States, does not seem apparent in the case of wine. However, per capita wine revenue was low in all states in which the tax rate was 10 cents or less per gallon. Per capita wine revenue generally was high in those states in which the tax rate was 50 cents or more per gallon.

Should Excise Tax Rate on Wine be Increased?—On the basis of data presented in this section, it is difficult to make accurate estimates as to the additional revenue Illinois would collect if excise tax rates on wine should be increased. A rate increase of approximately 50 percent in 1959 resulted in slightly over $1 million additional excise tax revenue.[93] This $1 million represented about a 37 percent increase in revenue from this source over the previous fiscal year. If an increase in the excise tax rate on wine would be as successful today as it was in 1959, a 50 percent increase in the tax rate would result in an increase in state wine revenue of $1.5 million.

In Illinois, as in most other states, taxes on wine as a percentage of the final retail selling price are low in relation to taxes on beer as a percentage of the final retail selling price of beer. The total Federal, states, and local tax per fifth of wine with an alcohol content of 14 percent, and selling for

---

[91] The control states receive a major portion of their wine revenue from profits of their selling operations. Therefore, as with the case of distilled spirits, only data from license states will be included in this section.

[92] The excise tax rate in Illinois is 23 cents per gallon on wine with an alcohol content of 14 percent or less, and 60 cents per gallon on wine with an alcohol content of from 14-21 percent. However, the tax rates on wine produced with grapes grown in Illinois is 8 cents per gallon on wine with 14 percent or less alcohol, and 23 cents per gallon if the alcohol content is over 14 percent. SOURCE: *State Tax Guide,* (Chicago: Commerce Clearing House, 1962). p. 3535.

[93] Illinois wine excise tax collections in 1959 were $3,014,000 (SOURCE: *Op. cit., Seventeenth Annual Report,* 1960). In 1960, collection from this source were $4,130,000 (see Table 15).

TABLE 15

Wine Consumption, State Revenue, and Tax Rates (1960)*

State	Wine Consumption (Gallons) (000) (1)	Per Capita Wine Consumption (Gallons) (2)	Excise Tax Revenue (000) (3)	Per Capita Excise Tax Revenue (4)	Tax Rates (Per Gallon) 14% or Less Alcohol (5)	14-21% Alcohol (6)
Alaska	175	.774	$ 80	$0.354	$0.50	$0.50
Arizona	1,476	1.134	531	.408	.36	.36
Arkansas	812	.455	392	.219	.75	.75
California	33,122	2.107	767	.049	.01	.02
Colorado	1,372	.782	369	.210	.20	.30
Connecticut	3,323	1.311	346	.136	.10	.10
Delaware	524	1.173	189	.424	.35	.35
Florida	4,469	.903	5,808	1.173	1.00	1.40
Georgia	888	.215	1,312	.329	1.00	2.00
Illinois	8,519	.845	4,130	.410	.23	.60
Indiana	1,926	.413	771	.165	.40	.40
Kansas	617	.283	199	.091	.15†	.40†
Kentucky	770	.253	385	.127	.50	.50
Louisiana	4,080	1.253	757	.232	.11	.21
Maryland	3,054	.985	611	.197	.20	.20
Massachusetts	5,643	1.096	1,705	.331	.60‡	.60‡
Minnesota	1,587	.465	944	.277	.23	.69
Missouri	2,996	.694	248	.057	.02	.10
Nebraska	587	.416	267	.189	.20	.55
Nevada	552	1.934	107	.375	.15	.25
New Jersey	8,467	1.396	950	.157	.10	.10
New Mexico	1,193	1.254	358	.376	.30	.30
New York	24,411	1.455	2,655	.158	.10	.10
North Dakota	236	.373	139	.220	.50	.60
Oklahoma	868	.373	421	.181	.36	.50
Rhode Island	1,050	1.222	211	.246	.20	.20
South Carolina	673	.283	694	.291	1.08	1.08
South Dakota	304	.447	84	.124	.15§	.30§
Tennessee	909	.255	636	.178	.70	.70
Texas	5,224	.545	1,273	.133	.132	.264
Wisconsin	2,619	.663	647	.164	.15	.30

*SOURCES: Data for columns (1) and (3), Wine Institute, Bulletin No. 1157 (5-11-62); data for columns (5) and (6), *Op. cit., Facts and Figures*, pp. 192-193. Population figures used in computing columns (2) and (4), April 1, 1960, *Op. cit., Compendium*, p. 56.

†Plus an enforcement tax of 2½% of gross receipts from retail sales.

‡Plus a tax of 23.25% of gross receipts from sales.

§Plus a tax of 10% of gross receipts.

$1.04 (including 4 cents retail sales tax) is 12 cents, or 11.5 percent of the final price of the product.[94] On a more expensive wine with an alcohol content of 20 percent, and retailing for, say, $1.30 (including 5 cents retail sales tax), the combined Federal, state, and local tax is 30.4 cents, or 23.4 percent of the final price to the consumer. However, as the price of wine with an alcohol content of over 14 percent increases, the combined tax as a percentage of the final retail selling price decreases.[95]

Since wine is undertaxed proportionately to beer, distilled spirits, and cigarettes, it is recommended that if excise tax rates applying to these other commodities are increased, the excise tax rate on wine should also be increased.

Summary

There are 33 states in which distilled spirits are distributed by private enterprise. The excise tax rates applicable to distilled spirits in 15 of these states are higher than the $1.52 per gallon rate levied in Illinois. The excise tax on distilled spirits in Illinois represents approximately 6 percent of the retail price per fifth of 86.8 proof "A" blend whiskey. However, when the Federal levy of $10.50 per gallon, and retail sales taxes are taken into consideration, the tax burden per fifth is over 56 percent of the final price to the consumer. The excise tax rate on distilled spirits is regressive since the same basic rate applies to the more expensive brands of whiskey as applies to the less expensive brands of whiskey (the tax as a percentage of the final retail price decreases as the price of the product increases—see footnote 47).

There does not appear to be a significant relationship between the variation in excise tax rates and the variation in per capita state distilled spirits revenue among the various license states. This lack of relationship between tax rates and revenue can be partially explained by the differences among the states in other taxes applied to distilled spirits: the number of people per retail outlet; the percentage of the population that live in areas in which it is legal to sell distilled spirits; the amount of retail and wholesale competition; and cultural and geographical factors.

Whether or not an increase in tax rates will be successful in producing more revenue depends upon the elasticity of demand for the product in question. The more inelastic the demand for a product, the more successful will be a tax rate increase. Students of liquor taxation are not in agreement about the elasticity of demand for distilled spirits. Some conclude that demand is elastic, while others argue that demand in relatively inelastic. The most important determinant of price elasticity of demand for a product is the availablity of good substitutes for that product. There are substitutes for distilled spirits that are legally distributed within a specific state. Some

---

[94] Federal excise tax rates on wine are, 17 cents per gallon (3.4 cents per fifth) if the alcohol content is 14 percent or less, and 67 cents per gallon (13.4 cents per fifth) if the alcohol content is between 14 and 21 percent. SOURCE: *Op. cit., Facts and Figures*, p. 120.

[95] A fifth of "20 percent" wine selling for $2.08 (including 8 cents sales tax) will have a combined tax of 33.4 cents (13.4 cents Federal tax, 12 cents state excise tax, and 8 cents retail sales tax) which is only 16.1 percent of the final price to the consumer.

of these substitutes are beer, wine, "moonshine," and liquor purchased through licensed outlets in neighboring states. Whether these other products are substitutes for legally distributed distilled spirits depends, among other things, upon the level of income of the individual, cultural and geographical factors, and, to some extent, law enforcement. These factors vary from state to state, consequently, price elasticity of demand for distilled spirits varies from state to state.

This writer does not believe that the demand for distilled spirits is as inelastic as was implied in the 1949 *Report of the Revenue Laws Commission,* and estimates that, assuming no major changes in economic activity or population, an increase of 50 cents in the distilled spirits excise tax rate will result in not more than a $4 million increase in excise tax revenue from this source. This tax rate increase will mean that the consumer will pay approximately 60 percent of the final retail price of distilled spirits to the various levels of government.

Since the consumer of distilled spirits already bears a disproportionate share of the burden of government expenditures merely because he chooses to consume this product, it was recommended that the excise tax rate applying to this product should not be increased at this time. It was further recommended that serious consideration be given to either lowering the $1.52 per gallon state excise tax rate levied upon distilled spirits, or exerting pressures on the United States Congress to reduce the $10.50 per gallon "temporary" Federal levy on this product.

In 1960, Illinois ranked fourth in total beer consumption, ninth in per capita consumption of this product, but only twentieth in per caipta state revenue collected from specific excise taxes levied on beer. The low per capita state beer revenue in Illinois is a result of the low excise tax rate applying to beer in that state. The excise tax rates on beer in 27 of the 41 states for which complete information on beer consumption and beer revenue was available for 1960 were higher than the 6 cents per gallon (13.5 cents per case of twenty-four 12-ounce containers) rate levied in Illinois.

There appears to be a statistically significant relationship between excise tax rates on beer and per capita state revenue from this source in the states located in the Northeastern quarter of the United States. The 1960 data from these states indicate that one could expect approximately a 33 cent increase in per capita state beer revenue for each 5 cent increase in the tax rate per case of twenty-four 12-ounce containers. It was estimated that a 10 cent per case increase in the excise tax rate applying to beer in the state of Illinois should increase state revenue from this source by about $7 million annually.

It was recommended that, if a more equitable tax system can not be adopted in Illinois, the excise tax rate on beer should be increased by approximately 10 cents per case of twenty-four 12-ounce containers. Even with the proposed tax rate increase, the individual who chooses to allocate part

of his income to beer consumption will be paying proportionately half the tax paid by the consumers of cigarettes and distilled spirits.

Illinois ranks third in both total consumption of wine and per capita revenue derived from excise taxes levied on wine. However, total revenue from this source is quite low in relation to state beer and distilled spirits revenue. It was estimated that a 50 percent increase in the excise tax rate applying to wine would increase state revenue from this source by only about $1.5 million annually.

It was recommended that, since wine is undertaxed proportionately to beer, distilled spirits, and cigarettes, the excise tax rates on wine should be increased if excise tax rates applying to any of these other commodities are increased.

THE TAXATION OF HORSE RACING

Pari-Mutuel Taxes

In the previous sections, per capita state tax revenue played an important role in the analysis of the taxation of tobacco products and alcoholic beverages. However, with regard to pari-mutuel taxes, per capita pari-mutuel tax revenue data are practically meaningless for purposes of analysis since the use of the product in question, or service as the case may be, is by no means universal. In other words, many people who pay taxes on cigarettes, alcoholic beverages, gasoline, and on general sales, do not "play the races." Another unique characteristic of horse racing is that many tourists and people from neighboring states may attend the races in a specific state. In addition, special races such as the Kentucky Derby, attract people from all sections of the country to witness, and place wagers on these specific contests. It is possible that per capita pari-mutuel revenue in a state with a small population, but an excellent racing program which attracts spectators from various sections of the country, will be much larger than per capita pari-mutuel revenue in a state with a large population, but only a mediocre racing program. However, even though per capita pari-mutuel data mean little in regard to analysis, it is interesting to note that Illinois ranks third among the 24 states that levy taxes on horse racing in both attendance and turnover, but only tenth in per capita revenue derived from this source (see Table 17).

Sources of State Revenue from Horse Racing—The most productive source of revenue from horse racing is the pari-mutuel tax, which is a percentage tax levied on the turnover (total amount wagered) at the track. In the 24 states in which wagering on horse races is legal, the track or racing association is allowed to deduct a specified percentage of the total amount wagered for the track's operating expenses, profits, and for such pari-mutuel taxes as may be imposed. This deduction is called the "take-out." The difference between the "take-out" and the total amount wagered is returned to the holders of winning tickets. Thus, if the allowable "take-out" is 15 percent, and the state pari-mutuel tax rate is 5 percent, 85 percent of all money

wagered is returned to the holders of winning tickets, 10 percent is retained by the track and 5 percent is paid to the state.

An additional source of revenue to several of the states that levy taxes on horse racing is breakage, which is the odd cents of the computed winnings of a ticket that are not returned to the ticket holder. To expedite payment of winning tickets, and reduce chances for error, winning tickets are not figured to the nearest cent. In most states today, the basis for breakage is to the nearest 10 cents. For example, if, based on the odds of the track, the winning tickets are computed to pay \$8.86, and if the basis for breakage is 10 cents the ticket holders receive \$8.80 per ticket, and six cents per ticket is retained as breakage. Eleven of the 24 states that levy taxes on horse racing share part (usually 50 percent) of the breaks with the track. Two states claim 100 percent of the breaks, and in the remaining 11 states, the entire breakage is retained by the track (see Table 16).

Other sources of state revenue from horse racing are: track license fees; occupational license fees, that is, fees imposed on jockeys, grooms, owners, and so forth; admission taxes, and the revenue from unpaid tickets.

Illinois collected \$19,565,000 from its levies on horse racing during the fiscal year ending November 30, 1961.[96] Of this tax revenue, \$16,872,000 came from pari-mutuel taxes, \$1,326,000 from breakage, and the remainder from track license fees, occupational license fees, and miscellaneous sources.[97] The pari-mutuel tax rate in Illinois is six percent (4 percent when the total handle does not exceed \$300,000 on any one day) of all money wagered on thoroughbred races, and 5½ percent of all money wagered on harness races. The basis for breakage in Illinois is 10 cents with the state receiving 50 percent of the breaks resulting from wagering on thoroughbred races, but the entire breakage that results from wagering on harness races remains with the track.[98]

Take-Out and Breakage—In 1947: "The several states regulating horse racing fix the take-out somewhere in the range of 10 to 15 percent with 10 percent being the most common. . . . A few states permit 15 percent."[99] Since that date, the range for "take-out" has been increased to between 12 and 17 percent, with 15 percent being the most common rate at the present time. The "take-out" in Illinois increased from 13 percent in 1947 to 14 percent in the Chicago area and 15 percent in the downstate area in 1961.[100] It can be seen from Table 16 that the amount of the "take-out" remaining with the track after pari-mutuel taxes have been deducted varies greatly from state to state. In South Dakota, a state that does not share in the breaks, the track retains 11 percent of the amount wagered. In several of the states, 9 or 10 percent of the amount wagered is retained by the track.

[96] "Statistical Reports on Horse Racing in the United States for the Year 1961," (Lexington, Kentucky: The National Association of State Racing Commissioners, 1962).
[97] *Ibid.*
[98] *Ibid.*
[99] *Op. cit.*, Morgan, p. 464.
[100] The National Association of State Racing Commissioners.

TABLE 16

Take-Out, Breakage, and Disposition of Same (1961)*

State	Take-Out (Percentage) (1)	Pari-Mutuel Tax Rate (Percentage of Wagers) (2)	Breakage: Basis (3)	Breakage: To State (Percentage) (4)
Arizona	15	4 on first $100,00 6 on over $100,00	10	none
Arkansas	15	5	10	33 1/3†
California ...	14	5 on first $10 million▲ 6 on next $10 million▲ 7 on next $55 million▲ 7½ on next $50 million▲ 8 on over $125 million▲	10	50 on $25 million or less, 100 on over $25 million
Colorado	15	5	10	none
Delaware	15‡	4½§	10¶	50•
Florida	15	8	5	100
Illinois	15**	6††	10	none
Kentucky ...	14§§	4 on first $18 million▲ 6 on over $18 million▲	10	50‡‡
Louisiana ...	15	5 on first $201,000 6 on next $200,000 7 on over $401,000	10	none
Maine	17	7	10	none
Maryland ...	12¶¶	5••	10	50***
Massachusetts	14†††	7‡‡‡	10	50
Michigan ...	13§§§	6½¶¶¶	10	50
Nebraska	12	2 on over $1 million	10	none
N. Hampshire	14•••	7½****	10	50
New Jersey ..	13††††	7 on first $40 million▲ 8 on over $40 million▲	10	100
New Mexico .	15	1 on first $250,000 2 on next $100,000 3 on next $50,000 5 on over $400,000	10	none
New York				
Saratoga ..	15	9	5	50
Long Island	15	10§§§§	5	60
Ohio	16½¶¶¶¶	4¼ on first $10,000 5¼ on next $40,000 6¼ on next $50,000 7¼ on next $300,000 8¼ on over $400,000	10	50••••

TABLE 16 (Continued)

State	Take-Out Percentage) (1)	Pari-Mutuel Tax Rate (Percentage of Wagers) (2)	Breakage: Basis (3)	Breakage: To State (Percentage) (4)
Oregon				
(opt. 1) . . .	12½	3 on first $66,000	5	none
		4 on next $67,000		
		5 on next $67,000		
		6 on over $200,000		
(opt. 2) . . .	15	5 on first $133,000	5	none
		6 on next $67,000		
		7 on over $200,000		
Rhode Island	15	8	10	50
S. Dakota . . .	14	3	10	none
Washington .	15	5	5	none
W. Virginia . .	15	6	10	none

*SOURCE: *Op. cit.*, The National Association of State Racing Commissioners.
†Plus 33 1/3% of breaks to city where track is located.
‡16% for harness races.
§3½% for harness races.
¶5 cents for harness races.
•none for harness races.
**14% in Chicago area.
††4% if daily handle does not exceed $300,000. 5½% on harness races.
‡‡none for harness races.
§§20% for harness races.
¶¶15% for harness races.
••3½% to 7% for harness races, 1 to 6% for quarter horses and fairs.
***100% of breaks on harness races if total break is over $4 million.
†††17% for harness races.
‡‡‡5½% to 9½% for harness races, 2 to 3½% for quarter horses and fairs.
§§§14% for harness races.
¶¶¶4½% for harness races.
•••17% for harness races.
****5½% to 9½% for harness races, quarter horses and fairs.
††††16% for harness races.
‡‡‡‡6 to 7% for harness races.
§§§§5 to 11% for harness races.
¶¶¶¶17½% for harness races.
••••after first $2,000 in any year.
▲annually.

However, in New York and New Jersey, the track keeps only from 5 to 6 percent of the amount wagered. The track retains 6½ percent of the turnover in Michigan, and 7 percent in Florida. In Illinois, the track retains either 8 or 9 percent of the amount wagered, depending upon the location of the track. Comparing data from Table 16 and 17, it becomes apparent that, in general, the tracks located in states with relatively low turnover retain a greater percentage of the "take-out" than do tracks located in states in which the turnover is relatively high.

Revenue and Relationships of Tax Rates to Revenue—In 1961, over one billion dollars was wagered at the tracks in the state of New York. During that same year, that state collected over $99 million from its levies on horse racing. California, with a turnover of slightly more than $500 million, collected approximately $38 million from this source. Illinois, in which

TABLE 17

Attendance, Turnover, and State Revenue From Horse Racing (1961)*

State	Attendance (000) (1)	Turnover (000) (2)	Total State Revenue (000) (3)	Per Capita State Revenue (4)	Pari-Mutuel Revenue (000) (5)	Pari-Mutuel Revenue Plus Breakage (000) (6)	Pari-Mutuel Revenue Plus Breakage as a Percentage of Total Revenue (7)
Arizona	323	$ 22,638	$ 1,027	$0.74	$ 1,017	$ 1,017	99.03
Arkansas	379	21,279	1,226	.68	1,064	1,157	94.37
California	6,690	505,834	38,006	2.32	32,579	37,696	99.18
Colorado	371	15,305	777	.44	765	765	98.46
Delaware	1,405	93,480	4,332	9.46	3,831	4,146	95.71
Florida	1,449	159,215	13,665	2.62	12,249	13,221	96.75
Illinois	4,272	294,205	19,565	1.91	16,872	18,225	93.15
Kentucky	928	52,842	2,500	.81	2,227	2,227	89.08
Louisiana	969	45,632	2,539	.76	2,489	2,489	98.03
Maine	254	15,822	1,120	1.13	1,107	1,107	98.84
Maryland	2,070	160,047	9,166	2.88	7,765	8,816	96.18
Massachusetts	2,138	108,078	7,556	1.44	6,796	7,413	98.11
Michigan	2,203	120,722	7,808	.98	7,043	7,805	99.96
Nebraska	781	39,103	786	.55	649	649	82.57
New Hampshire	1,462	76,686	5,347	8.61	4,895	5,333	99.74
New Jersey	3,115	292,357	25,306	4.05	21,807	25,145	99.36
New Mexico	621	35,484	454	.46	358	358	78.85
New York	13,611	1,061,042	99,076	5.82	91,929	95,323	96.21
Ohio	2,938	133,861	9,774	.99	9,718	9,718	99.43
Oregon	274	9,980	472	.26	439	439	93.01
Rhode Island	1,337	91,656	7,894	9.10	7,332	7,859	99.56
South Dakota	85	4,500	137	.20	135	135	99.54
Washington	331	26,501	1,342	.46	1,325	1,325	98.73
West Virginia	1,553	80,679	4,982	2.69	4,749	4,749	95.32
Total	49,559	$3,466,943	$264,857	$2.51	$239,140	$257,742	97.31

*SOURCE: National Association of State Racing Commissioners. Population figures used to compute per capita revenue, July 1, 1961. *Op. cit.*, *Compendium*, p. 56.

over $294 million was wagered at its tracks, received $19.6 million from its levies on horse races.

The pari-mutuel system is quite unique in that the individual states not only determine the tax rate, but also determine the percentage of the turnover that remains with the track or racing association. Therefore, if the turnover is identical in two states, a higher tax rate in one state will result in higher pari-mutuel tax collections in that state than in the other state. An increase in the tax rate in either state will not cause a reduction in turnover unless the state also increases the "take-out." In other words, the increased tax burden that results if tax rates are increased will not be shifted forward to the betting public if the "take-out" remains the same, unless the track raises admission prices in an attempt to regain part of the revenue lost to the government because of the increase in tax rates. However, if admission prices are increased, attendance may decline, resulting in a reduction in admissions revenue to the track, and possibly a reduction in turnover.

Column (2) and column (5) of Table 17 show that in several cases the amount wagered in one state was greater than the amount wagered in a second state, but that state pari-mutuel tax revenue was higher in the state with the lower turnover. This relationship existed between Arizona and Arkansas, Delaware and Rhode Island, Maryland and Florida, Illinois

TABLE 18

Thoroughbred Turnover Retained by the Track (1961)

State	Thoroughbred Turnover* (000) (1)	Thoroughbred Pari-Mutuel Revenue* (000) (2)	Take-Out† (Percentage of Turnover) (3)	Thoroughbred Turnover Retained by Track‡ (Percentage of Turnover) (4)
Arizona	$ 21,869	$1,017	15	10.4
Arkansas	21,279	1,064	15	10.0
Kentucky	52,599	2,218	14	9.8
Louisiana	45,632	2,489	15	9.5
New Hampshire	45,025	3,152	14	6.5
Maryland	123,599	6,180	12	7.0
Ohio	98,544	7,670	16.5	8.7
Rhode Island	91,656	7,332	15	7.0
West Virgiina	77,438	4,555	15	9.0
Massachusetts	69,294	4,851	14	7.0
New Mexico	31,515	318	15	14.0
Washington	26,501	1,325	15	10.0

*SOURCE: National Association of State Racing Commissioners.
†SOURCE: Table 16.
‡Column (1) Table 16 minus column (2) Table 16. With variable rates, column (2) Table 18 divided by column (1) Table 18 and subtract the quotient from column (3) Table 18.

and New Jersey, Kentucky and Louisiana, and West Virginia and New Hampshire. However, since in most states the pari-mutuel tax rates applying to harness racing are different from the pari-mutuel tax rates applying to thoroughbred racing.[101] precise comparisons are quite difficult to make.

Data from 12 states in which this relationship existed between pari-mutuel turnover from thoroughbred racing and pari-mutuel tax revenue derived from thoroughbred racing are included in Table 18. The interesting feature of Table 18 is column (4), the thoroughbred turnover retained by the track, which was derived by subtracting the average tax rate from the "take-out." In each case, except for the Maryland-Ohio-Rhode Island case, the percentage of turnover retained by the track was less in those states with the higher tax rates than in those states with the lower tax rates. In Ohio and Rhode Island, where turnover was less than in Maryland, but pari-mutuel tax revenue was higher, a portion of the higher revenue was shifted to the betting public since the "take-out" in both Ohio and Rhode Island was higher than the "take-out" in Maryland. The difference between pari-mutuel tax revenue in Louisiana and Kentucky was also partially shifted forward to the betting public for the same reason. However, the "take-out" was the same in all four states in the first and last case (Arizona-Arkansas, and New Mexico-Washington). In 1961, West Virginia left 9 percent of the turnover to the track, while Massachusetts, which collected more pari-mutuel tax revenue from thoroughbred racing than did West Virginia, left 7 percent of the turnover to the track. The difference in tax revenue between these two states was not shifted to the betting public since in Massachusetts the holders of winning tickets received 86 percent of the turnover, while in West Virginia 85 percent of the turnover was paid to the holders of winning tickets. This same relationship occurred in the Louisiana-New Hampshire case. In New Hampshire, where the tax rate was higher than the rate in Louisiana, the track paid 86 percent of the turnover to winners, while in Louisiana, the holders of winning tickets received 85 percent of the turnover. New Hampshire left only 6.5 percent of the amount wagered to the track, whereas, the track retained 9.5 percent of the amount wagered in Louisiana.

Table 19 was set up in order that a comparison could be made between Illinois and the other 5 states in which wagering on thoroughbred races exceeded $100 million in 1961. Thoroughbred pari-mutuel tax rates ranged from a low of 5 percent in Maryland, a state in which pari-mutuel tax revenue from thoroughbred racing was out of proportion to pari-mutuel tax revenue in the other states in which over $100 million was wagered on thoroughbred races, to 10 percent in New York. The rate of 6 percent in Illinois is low in relation to the rates in other states with comparable turnover.

During 1961, from 8 percent to 9 percent of the thoroughbred turnover

[101] See footnotes to Table 16.

TABLE 19

Thoroughberd Revenue and Tax Rates (1961)

State	Thoroughbred Turnover* (000) (1)	Thoroughbred Pari-Mutuel Revenue* (000) (2)	Take-Out† (Percentage of Turnover) (3)	Average Pari-Mutuel Tax Rate‡ (Percentage of Turnover) (4)	Thoroughbred Turnover Retaind by Track§ (Percentage of Turnover) (5)
New York	$544,251	$54,171	15	9.9¶	5.1¶
California	387,658	25,876	14	6.7	7.3
New Jersey	273,279	20,662	13	7.6	5.4
Illinois	225,775	13,108	14 or 15¶	5.8¶	8.2 or 9.2¶
Florida	159,215	12,249	15	8.0	7.0
Maryland	123,599	6,180	12	5.0	7.0

*SOURCE: National Association of State Racing Commissioners.
†SOURCE: Table 16.
‡Column (2) Table 16. For California, Illinois, New York and New Jersey, where variable rates were used, average tax rate was derived by dividing column (2) Table 19 by column (1) Table 19.
§Column (3) Table 19 minus column (4) Table 19.
¶Depending upon the location of the track.

was retained by the tracks in Illinois. In the other five states the tracks retained from 5 to 7.3 percent of the thoroughbred turnover. In absolute dollars and cents terms this comparison is even more meaningful. Multiplying the figures of coulmn (5), Table 19, by the corresponding figures in column (1), Table 19, we find the dollar amount of thoroughbred turnover that is retained by the track. In Illinois (using 8.7 percent as the multiplier), the tracks retained approximately $19.6 million, whereas, in New Jersey, a state in which wagering on thoroughbred races was about $50 million greater than in Illinois, the tracks retained approximately $14.8 million. When breakage is taken into consideration, this spread in pari-mutuel revenue retained by the tracks in New Jersey and Illinois becomes even greater. Tracks do not receive any part of the breaks in New Jersey. In Illinois, tracks receive 50 percent of the breaks, or about $1.4 million. Adding breakage to thoroughbred "take-out" retained by the tracks in Illinois resulted in $20.995 million retained by the tracks as compared to $14.757 million retained by the tracks in New Jersey. The difference in revenue retained by the track in these two states probably was not shifted to the betting public in New Jersey since in that state the holders of winning tickets receive 87 percent of the turnover, while in Illinois, the winners receive from 85 to 86 percent of the turnover, depending upon the location of the track. Florida collected almost as much pari-mutuel tax revenue in 1961 as was collected in Illinois, but left the tracks only $11.1 million.[102]

[102] In 1960, turnover in Florida was $43 million less than in Illinois. However, Florida collected almost $1 million more than was collected in Illinois, and left the tracks $11.9 million, whereas, Illinois left the tracks approximately $18.5 million plus 50 percent of the breaks. SOURCE: National Association of State Racing Commissioners.

Other State Revenue From Horse Racing

Only New York collected more revenue from license fees and admissions taxes than did Illinois in 1961. Column (7), Table 17 indicates that in 1961 pari-mutuel taxes and breakage accounted for over 98 percent of the total state revenue from levies on horse racing in over half the states in which wagering on horse races is subject to state taxation. Illinois received only 93.2 percent of its horse racing revenue from pari-mutuel taxes and breakage. Only four other states collected a greater percentage of their horse racing revenue from license fees, admissions taxs, and miscellaneous sources than did Illinois, and in each of these four states total state revenue derived from levies on horse races was relatively small.

Should Illinois Increase its Levies on Horse Racing?—From the previous

TABLE 20

Other Sources of State Revenue (1961)*

State	License Fees (000)	Admissions Taxes (000)	Miscellaneous Sources (000)
Arizona	$ 8	$ none	$ 2
Arkansas	30	15	24
California	46	none	264
Colorado	11	none	1
Delaware	7	178	none
Florida	54	385	5
Illinois	657	533	150
Kentucky	161	112	none
Louisiana	16	10	24
Maine	8	none	5
Maryland	182	82	86
Massachusetts	101	none	42
Michigan	2	none	2
Nebraska	33	105	none
New Hampshire	14	none	1
New Jersey	23	none	138
New Mexico	72	23	1
New York	379	2,509	866
Ohio	27	none	none
Oregon	32	none	1
Rhode Island	18	none	17
South Dakota	2	none	none
Washington	17	none	none
West Virginia	175	none	58

*SOURCE: National Association of State Racing Commissioners.

analysis it appears that if the pari-mutuel tax rate applicable to thoroughbred turnover in Illinois had been 7 percent in 1961, the state, assuming that the percentage "take-out" remained constant, would have collected approximately $15.8 million from this source, which is about $2.7 million more revenue than was collected from that source during 1961. Such an increase would still have left the tracks in Illinois more revenue than was left the tracks in New Jersey, Florida, or Maryland in that year.

If we assume that the admissions tax on horse racing attendance is not a tax on gambling, but a tax on the privilege of watching a horse race, and if we further assume that the pari-mutuel tax is a levy on the privilege of gambling, just as the cigarette tax is a levy on the privilege of smoking cigarettes, there is no question that the betting public is undertaxed in relation to the smoking (and drinking) public. The weighted average price per package of cigarettes in Illinois as of November 1, 1961, was 26 cents.[103] The 4 cent per package cigarette tax levied in Illinois represents 15.4 percent of this average retail price. This 15.4 percent rate does not include the State retail sales tax of 3.5 percent which applies to the sale of cigarettes. As indicated on Table 19, the average pari-mutuel tax rate on thoroughbred turnover in Illinois is 5.8 percent. If we deduct the 4 cent per package state cigarette tax from the average retail price per package of cigarettes, and apply the 5.8 percent thoroughbred pari-mutuel tax rate to cigarettes, the average retail price of cigarettes in Illinois would be 23 cents per package. If, since the Federal Government does not levy pari-mutuel taxes, we can deduct both the 4 cent per package state tax and the 8 cent per package Federal tax from the price of a package of cigarettes and apply the 5.8 percent pari-mutuel tax rate to cigarettes, the average retail price per package of cigarettes in Illinois would be 14.8 cents. Federal and State excise taxes in Illinois account for 46.2 percent of the average retail price per package of cigarettes.[104] If this tax rate, plus the "take-out" retained by the track were to be applied to thoroughbred turnover, the holders of winning tickets in Illinois would receive from 54.4 to 55.4 percent of the thoroughbred turnover rather than the 85 to 86 percent that they receive today. If distilled spirits taxes rather than cigarette taxes are compared with pari-mutuel taxes this difference in tax burdens becomes even more pronounced since over 55 percent of the retail price of a fifth of typical "A" blend whiskey is in the form of tax revenue to some level of government.[105]

In an attempt to equalize state tax burdens between the betting public and the smoking (and drinking) public, it is recommended that the pari-mutuel tax rates applicable to thoroughbred turnover should be increased from 4 percent if the daily handle does not exceed $300,000, and 6 percent of turnover over $300,000, to 6 percent if the daily handle does not exceed $300,000 and 8 percent of turnover over $300,000. "Take-out" should be

---

[103] *Op. cit., Cigaret Taxes*, p. 19.
[104] *Ibid.*, p. 19.
[105] *Supra*, p. 38.

increased by one percentage point which should shift at least one-half of this additional levy to the betting public. It is doubtful that a reduction of one percentage point in thoroughbred turnover returned to the holders of winning tickets will result in more than a very slight drop in the turnover itself. The other one percentage point increase in pari-mutuel tax rates would mainly be absorbed by the tracks, which would leave them between 7 and 8 percent of the turnover, which would be more in line with the thoroughbred turnover retained by tracks in the other states in which wagering on thoroughbred races exceed $100 million per year.

Assuming no major changes in economic activity or population, this additional 2 percent levy should increase state tax collections by $5 million. It is further recommended that the revenue derived from this additional levy should be allocated to the General Fund, and eventually all revenue derived from levies on horse racing should go into the General Fund.

Harness racing is given preferential tax treatment in most states that levy taxes on harness racing turnover (see Table 16). Whether this favorable treatment is justified, or a result of political manipulations is not known to this writer. However, it can be argued on economic grounds that if society is interested in attaining an optimum allocation of resources, "nonessential" industries that are unable to operate at a profit without government subsidies (preferential tax treatment being a form of government subsidy), should be left to their natural fate.

It is recommended that the pari-mutuel tax rate on harness racing turnover should be increased from the current rate of 5.5 percent to 7 percent, and that the "take-out" be increased from 15 to 16 percent. This 1.5 percentage point increase in the tax rate should increase state revenue by a minimum of $1 million. Since the "take-out" is to be increased by one percent, at least two-thirds of this additional levy will be shifted to the betting public. It is doubtful that reducing the amount of harness turnover returned to the holders of winning tickets from 85 percent to 84 percent will result in more than a very slight reduction in harness turnover.

Admission taxes, levied on the spectator rather than on the wagerer, and track and occupational license fees are already high in Illinois, and there appears to be no reason to recommend that these levies be increased at this time.

State Regulated Off-Track Betting

In cities such as New York, Chicago, and Detroit, and in many much smaller communities, a large proportion of betting on horse races is not carried out at a track, but rather through bookmakers. The "bookie," or the person who places a bet with him, does not pay state taxes on the amount wagered.

In an attempt to gain additional revenue for New York City, Mayor Wagner has tried, during the past several years, to convince the State Legislature to adopt a program of legalized, controlled off-track betting on horse

races. Under such a program, strategically located betting establishments would be set up in New York City. These establishments would be controlled by the state, and the betting process would be similar to the process at the track where an individual purchases a ticket representing a specific horse to either win, place (second place), or show (third place). It is hoped that legislation of this nature would not only provide revenue for the city and state, but would also eliminate the bookmakers. As recent as December 5, 1961, Mayor Wagner ". . . repeated his arguments that legislation of off-track betting would cut down corruption, strike a blow at underworld control of gambling and provide enough revenue to enable the city to eliminate or reduce some of its present special taxes."[106]

In a statement before the Joint Fiscal Committee of the New York State Legislature on February 15, 1962, Abraham D. Beame, Comptroller of New York City said: "(the State) has . . . ignored our repeated pleas for the right to tap a source of revenue from racing. I refer to revenue from controlled off-track betting, which could yield $100 million a year to the city and an equal amount to the State."[107] Speaking of the advantages of controlled off-track betting, Comptroller Beame said:

> We have been told that off-track betting is immoral. Can it be moral for the state to collect $106 million from betting at the tracks, and immoral to gain revenue from off-track betting? Is it immoral to deprive the underworld of its main source of revenue—the money it uses to support dope traffic, prostitution and other nefarious enterprises?[108]

Several days earlier with reference to implementing a program of legalized, controlled off-track betting, Mr. Beame said:

> ". . . The International Business Machine Corporation, . . ., has been experimenting for some time, at no cost to the city, with a method of handling off-track, pari-mutuel betting integrated with on-track wagering. Mr. Beame said the corporation had indicated that it would have a permanent installation ready quickly if off-track betting were authorized."[109]

Regardless of many efforts, New York City has been unable to convince the Legislature that controlled off-track betting should be legalized.

Although the revenue potential of legalized off-track betting is tremendous, it is extremely difficult to make estimates of the additional revenue Illinois could collect from this source. However, because of the similarity of New York City and Chicago, the state would probably receive over $50 million each year from a levy or service charge on off-track wagering.

There are two major arguments in favor of legalized, controlled off-track gambling. The first is the enormous amount of revenue that can be derived from this source. The Comptroller of New York City estimates that if such legislation would be adopted in New York, the total yield from a

---

[106] *New York Times*, December 6, 1961, p. 43.
[107] News Release from the Office of the Comptroller, New York City, February 15, 1962.
[108] *Ibid.*
[109] *New York Times*, February 12, 1962, p. 19.

service charge on off-track wagering on horse races could be $200 million each year. Proponents of legalized off-track betting also argue that such legislation would practically eliminate the "bookie," and, consequently, one of the main sources of revenue to the underworld. This argument continues that if this source of revenue is cut off, other forms of crime and vice would diminish.

Opponents of legalized off-track betting on horse races argue that such legislation should not be enacted because of the immoral aspects of gambling. The state should not make it easier for people to commit immoral acts, even though this action on the part of the state may cause a reduction in other immoral acts. In other words, the ends to not justify the means.[110] Other opponents of legalized off-track betting argue that the provision of easily accessible gambling facilities will tend to draw money to the betting window that otherwise would have been spent for necessities. As New York State Senator Barret said, "I can't think of a quicker way to impoverish more people."[111]

Because of the vast amount of revenue that can be derived from this source, and the possibility that a program of legalized, controlled off-track betting will eliminate a source of revenue to the underworld, this writer recommends that the Illinois Legislature give serious consideration to the legalization of off-track wagering on horse races, especially in the Chicago area.

Summary

In 24 states it is legal to wager on horse races, if that wagering is carried out at the track. There are several sources of revenue to the various states from horse racing. The most productive of these sources is the pari-mutuel tax, which is levied as a percentage of the total amount wagered at the track. Of the amount wagered, called turnover, a specified percentage is retained by the track for operating expenses, profits and to pay such pari-mutuel taxes as may be imposed. The difference between this percentage amount retained by the track, called "take-out," which is determined by law in each state, and the turnover is paid to the holders of winning tickets. For example, in the Chicago area, the "take-out" is 14 percent, and the state pari-mutuel tax rate is 6 percent of all money wagered on thoroughbred races if the daily handle exceeds $300,000. Therefore, the holders of winning tickets are returned 86 percent of all money wagered, the state receives 6 percent of the amount wagered, and 8 percent of the amount wagered is retained by the track. An additional source of revenue to the state is breakage, which is the odd cents of the computed winnings of a ticket that are not paid to the holders of winning tickets. For example, the winning tickets may be computed to pay $4.68, but if the basis for

[110] The Protestant Council of the City of New York has constantly opposed "off-track betting parlors" in New York City. SOURCE: *New York Times*, December 11, 1961 ,p. 49.
[111] *New York Times*, January 31, 1962, p. 19.

breakage is 10 cents, the holders of winning tickets receive only $4.60 per ticket. The State of Illinois receives 50 percent of the breaks on thoroughbred races, but none of the breaks on harness races. States also receive revenue from track and occupational license fees, admissions taxes, and from other miscellaneous sources. During 1961, Illinois collected over $19.5 million from its levies on horse racing. Of this amount, approximately $16.9 million came from pari-mutuel taxes, $1.3 million from breakage, and the remainder from license fees, a 20 cent admissions tax, and miscellaneous sources.

Since the states regulate both the pari-mutuel tax rate and the "take-out," an individual state can decide upon whom the burden of an additional tax shall rest. If the tax rate is increased, but the percentage "take-out" remains constant, the track is unable to shift the tax to the betting public since the track, after the tax increase, must pay the same percentage of the turnover to the holders of winning tickets as it did before the tax rate was increased. If, as the tax rate is increased, the percentage "take-out" is increased, the track is able to shift most of the tax to the betting public since the holders of winning tickets now receive a lower percentage of the turnover.

In comparing data for the six states in which thoroughbred turnover exceeded $100 million in 1961 (see Table 19), it was shown that although the percentage "take-out" in Illinois was not out of line with the "take-out" of the other five states, the percentage of the total turnover retained by the track was considerably higher in Illinois than in those other states. In absolute terms, the tracks in Illinois retained, including breakage, $6.2 million more than the tracks retained in New Jersey. Thoroughbred turnover in New Jersey was almost $50 million higher than in Illinois, and that state received about $7.6 million more thoroughbred pari-mutuel revenue than did Illinois. Illinois, with a thoroughbred turnover of $67 million more than Florida, collected only $859,000 more thoroughbred pari-mutuel revenue than did Florida, but left its tracks $9.9 million more than was retained by the tracks in Florida. In 1960, Florida, with a turnover of $43 million less than in Illinois, collected more pari-mutuel revenue than did Illinois, and left the tracks only $11.9 million, whereas the tracks in Illinois retained approximately $18.5 million plus 50 percent of the breaks.

In the State of Illinois, the betting public is undertaxed in relation to the smoking (and drinking) public. The specific excise tax on cigarettes in Illinois, figured as a percentage of the weighted average retail price per package of cigarettes is 15.4 percent, while the average pari-mutuel tax rate in Illinois is 5.8 percent of the total amount wagered. Taking Federal excise taxes into consideration, the combined Federal and state excise taxes account for 46.2 percent of the average retail price per package of cigarettes in Illinois. If this rate, plus the "take-out" retained by the track would be applied to thoroughbred turnover, the holders of winning tickets would re-

ceive about 55 percent of the turnover rather than the 86 percent they receive today.

In an attempt to equalize state excise tax burdens among the consumers of various goods and services that are subject to state excise taxes, it was recommended that the thoroughbred pari-mutuel tax rate be increased by 2 percentage points and that the rate applying to harness racing turnover be increased by 1.5 percentage points. "Take-out" should be increased by one percent which will place a part of the burden of the additional taxes upon the track. Assuming no major changes in economic activity or population, the State should collect an additional $5 million from the rate increase on thoroughbred turnover, and an additional $1 million from the rate increase on harness turnover. The revenue derived from these additional levies should be allocated to the General Fund, and eventually, all revenue derived from levies on horse racing should go into the General Fund.

Admissions taxes, levied on the spectator rather than the bettor, and license fees are already high in Illinois, and should not be increased at this time.

Mayor Wagner of New York City has attempted to convince the Legislature of New York State to enact legislation that would legalize off-track wagering on horse races. Under this program betting establishments, controlled by the state, would be set up at strategic locations. The betting process would be similar to the process at the track, with the exception that the individual placing a bet would not attend the specific race. Proponents of such a program argue that in addition to the vast amount of revenue to be derived from this source, it would tend to eliminate the "bookie," and consequently, a main source of revenue to the underworld. Opponents of legalized off-track wagering on horse races argue that, because of the immoral aspects of gambling, this type of legislation should not be adopted. Others argue that this program will tend to draw money that otherwise would have been spent for necessities to the betting window.

Because of the vast amount of revenue that can be derived from this source (upwards of $50 million per year), and the possibility that a program of legalized, controlled off-track betting will eliminate a source of revenue to the underworld, this writer recommended that the Illinois Legislature give serious consideration to the legalization of off-track wagering on horse races, especially in the Chicago area.

CHAPTER XXII

TAXATION OF INSURANCE COMPANIES

By Robert I. Mehr*

Insurance companies provide an important source of revenue to the states. In 1960, insurance companies paid nearly $600,000,000 to the states in premium taxes and fees. Illinois collected over $31,000,000.

THE INSURANCE BUSINESS IN ILLINOIS

Helpful to an appreciation of the problems of taxing insurance companies is some understanding of the business of insurance as it is conducted in Illinois. Insurance companies serve two important functions in the economy of the state. They operate as risk-bearing institutions and as financial intermediaries. Their net income, therefore, is derived from underwriting profits and investment gains. As will be seen presently, however, not all insurers operate as financial intermediaries nor are all of them exposed to the opportunity for underwriting profit.

Types of Insurance Written in Illinois

The Illinois Insurance Code authorizes insurers doing business in Illinois to write the following types of insurance:

Class 1: Life, Accident, and Health Insurers
- (a) Life
- (b) Accident and Health

Class 2: Casualty, Fidelity, and Surety Insurers
- (a) Accident and Health
- (b) Vehicle
- (c) Liability
- (d) Workmen's Compensation
- (e) Burglary and Forgery
- (f) Glass
- (g) Fidelity and Surety
- (h) Miscellaneous
  - (1) boiler and machinery
  - (2) water damage
  - (3) credit
- (i) Other Casualty risks not otherwise specified under Classes 1 or 3 which may be properly classified under Class 2
- (j) Contingent losses resulting from causes listed under Class 2
- (k) Livestock

*The author is Professor of Finance at the University of Illinois.

Class 3: Fire and Marine Insurers

(a) Fire
(b) Elements (earthquake, windstorm, etc.)
(c) War, riot, and explosion
(d) Marine and transportation
(e) Vehicle
(f) Property damage, sprinkler leakage, and crop
(g) Other fire and marine risks not otherwise specified under Classes 1 or 2 which may be properly classified under Class 3
(h) Contingent losses attributable to any of the causes listed under Class 3

An insurer authorized to write Class 1 lines is called a life insurer and cannot write any lines other than these lines. An insurer authorized to write Class 2 lines is called a casualty insurer; and, if it is also authorized to write one or more Class 3 lines, it is called a casualty multiple line company. An insurer authorized to write Class 3 lines is called a fire insurer; and, if it is also authorized to write one or more Class 2 lines, it is called a fire multiple line insurer.

The Size of the Insurance Business in Illinois

In 1961, 482 life insurers did business in Illinois, including monoline health insurers and non-profit hospital, medical, and health service corporations. Fire insurers doing business in Illinois numbered 253 including 194 farm mutuals. Casualty insurers totaled 109; and there were 236 fire multiple line companies and 169 casualty multiple line insurers, making a grand total of 1,249 insurers doing business in Illinois. These insurers wrote a total of $2,360,122,099 in premiums in the State of Illinois. These figures do not include the more than $12 million of premiums written in Illinois by unauthorized insurers (those insurers operating without a certificate of authority from the Director) through licensed surplus line agents and brokers. (Licensed surplus line agents and brokers may procure policies for Illinois risks from non-admitted insurers only when the coverage required cannot be obtained from insurers duly authorized to transact business in the state). These figures also do not include insurance contracts negotiated, written, and serviced outside of Illinois on Illinois risks, that is, business placed with non-admitted insurers who technically are in no way doing an insurance business in Illinois.

Authorized insurers may be either domestic, foreign, or alien. A domestic insurer is one domiciled within the borders of the state. A foreign insurer is one domiciled within the United States but in some other state. An alien insurer is one domiciled outside of the United States. Of the 1,249 authorized insurers doing business in Illinois in 1961, 493 were domestic insurers, 693 were foreign insurers, and 63 were alien insurers. Of the $2,360,122,099 of premiums written by authorized insurers in Illinois,

$710,334,990 were written by domestic insurers, $1,583,660,736 by foreign insurers, and $66,126,373 by alien insurers.

Types of Life and Health Insurers

Insurers writing Class 1 lines of insurance (life and health insurance) in Illinois are of six types: mutual benefit associations, burial insurance societies, non-profit hospital, medical, and health service corporations, fraternal benefit societies, assessment legal reserve life and health companies, and old line legal reserve life insurance companies. Table 1 shows the amounts of premiums written in 1961 in Illinois by each of these types of insurers.

Each of the above types of insurers may be briefly described: Four mutual benefit associations with 5,827 members (1961) and 27 burial insurance societies with 54,323 members (1961) operate in Illinois. The mutual benefit associations have assets of $120,848 and life insurance in force amounts to $3,279,975 (1961). The burial societies have assets of $1,606,986 and $19,168,310 of life insurance in force (1961). Mutual benefit associations operate on an assessment plan with all members subject to the same assessment except that members under age 16 are assessed one-half of the assessment levied on all other members. The scale of benefits is based on the age of entry into the association. For example, those who enter between ages 16 and 40 are entitled to a $1,000 benefit whereas those entering between ages 41 and 45 are entitled to an $800 benefit, and so on. The burial insurance societies are allowed to write insurance up to $500 and may charge an advance premium or operate on an assessment plan. Under the current Illinois Insurance Code no new mutual benefit associations can be formed,

TABLE 1

Premiums Written in Illinois in 1961 by Admitted Life and Health Insurers*

Type of Insurer	Domestic Insurers	Foreign Insurers	Alien Insurers	Total
Mutual Benefit Associations	$ 68,020	$	$	$ 68,020
Burial Ins. Societies ...	91,870			91,870
Non-profit hosp., etc., Corp.	152,891,408			152,891,408
Fraternal Benefit Societies	11,744,791	13,875,177	1,118,231	26,738,199
Assessment Legal Reserve Cos.	13,435,297			13,435,297
Old Line Legal Reserve Cos.	198,195,915	987,206,454	21,658,198	1,207,060,567
Total	$376,427,301	$1,001,081,631	$22,776,429	$1,400,285,361

*SOURCE: Compiled from tabular numbers 3, 4, 5, and 6 of the Summary of Annual Statements prepared by the Illinois Director of Insurance, 1962.

but new burial insurance societies are not prohibited. Various restrictions are placed on the operation of both mutual benefit associations and burial insurance societies, but these are of no concern here.

One non-profit hospital service corporation, two non-profit medical service plan corporations, and five non-profit voluntary health service plan corporations operated in Illinois in 1961 having total assets equal to $64,292,700, and an aggregate net income of $6,616,042. These non-profit organizations provide a method for the prepayment of the cost of hospital, surgical, and general medical care for its subscribers. They include the well-known Blue-Cross and Blue-Shield type of insurance operation. The non-profit medical service plan corporations and the non-profit voluntary health service plan corporations are governed by the provisions of the "General Not for Profit Corporation Act" and are therefore declared to be charitable and benevolent corporations. Their funds and property are exempt from every state, county, district, municipal, and school tax or assessment, and all other taxes and license fees. Non-profit hospital service corporations are exempt from all state, county, district, municipal and school taxes other than taxes on real estate and office equipment.

Forty domestic, 75 foreign, and one alien fraternal benefit societies with total assets of $2,778,970,014 and with $10,572,957,714 of life insurance in force operated in Illinois in 1961. These societies had $1,078,932,782 of life insurance in force in Illinois. "A fraternal benefit society is any fraternal corporation, society, order, or voluntary association without capital stock, organized and carried on solely for the mutual benefit of its members and their beneficiaries and not for profit, and having a lodge system with ritualistic form of work and a representative form of government, and which shall make provision for the payment of death, sick, or disability benefits, or both."[1]

Several features distinguish fraternal insurers from the old line mutual insurers: the lodge system, representative form of government, "open" contracts, less strict regulation, and a tax-free status (except for taxes on real estate and office equipment). In some cases, the lodge system of a fraternal benefit society is merely a token, especially when the society has reached a stage of development just short of "old line." Educational and charitable activities are more important to many fraternals than the rituals of former years.

Fraternals must issue an "open" policy in which the bylaws and rules of the organization are a part of the insurance contract and any amendment to them is automatically an amendment to the policy as to rates and provisions. Also, upon impairment of a society's reserves, members may be required either to make an additional payment or accept a lien against their certificates.

[1] *Combined Statistics and Consolidated Charts of Fraternal Societies*, 1962 Edition, Indianapolis: The Fraternal Monitor, p. 7.

State regulation of fraternals generally is less strict than that applying to old line companies: reserves may be computed on a less conservative basis, and fraternal sales representatives need not be licensed.

Eighteen domestic assessment legal reserve life insurance companies and three domestic assessment accident and health companies with total assets of $18,019,517 and $138,022,399 of life insurance in force operated in Illinois in 1961. An assessment legal reserve life insurance company is a mutual insurer which maintains the reserve required by law for legal reserve life insurance companies (except lower reserves are permitted) but which retains a "contingency clause" in its policies in lieu of the required free surplus. Under this clause the company can call for additional premiums through assessments. When the company accumulates the minimum free surplus required of mutual legal reserve life insurance companies, the assessment clause can be dropped and the company can be converted into a mutual legal reserve life insurance company subject to the higher minimum reserves required of these companies.

Seventy-four domestic, 217 foreign, and seven alien legal reserve life insurance companies did business in Illinois in 1961. The domestic companies had $6,338,583,299 of life insurance in force in Illinois, the foreign companies had $36,929,128,849 in force in Illinois, and the alien companies, $576,447,280. In addition, there were three domestic companies and five foreign companies writing accident and health insurance only.

Legal reserve life insurance companies may be either capital stock corporations or mutual corporations. In a stock company, the individual shareholders advance the money to organize the insurer, and, in return, they share in the profits and losses. The stock life insurer functions in exactly the same way as other incorporated business organizations: management control theoretically rests with the shareholders, who elect the board of directors, which, in turn, elects the executive officers.

A mutual insurance company is distinguished from a stock company in that voting control is technically in the hands of the policyholders, who theoretically elect the board of directors, which, in turn, elects the officers of the company who supervise its operations. In case the premiums collected from policyholders prove to be more than needed to pay claims, set up the legal reserves and needed surplus, and pay operating expenses, the excess is returned periodically as a policy "dividend" according to formulas devised to return to each policyholder his equitable share. Stock companies may write participating policies in which case "dividends" are paid both to policyholders and to stockholders. In terms of the number of companies, stock insurers dominate the insurance scene but in terms of amounts of insurance in force mutual insurers are the dominant life insurance carriers.

Of the 298 legal reserve life insurance companies doing business in Illinois in 1961, 75 were mutual companies and 223 were capital stock companies. Of the $44,845,160,000 of legal reserve life insurance in force

in Illinois in 1961, $27,873,066,000 were underwritten by mutual companies and $16,972,094,000 by stock companies. Of the $1,207,060,567 in life insurance premiums written in Illinois in that year by these companies, $624,491,091 were written by mutuals and $572,569,476 by stock companies.

Types of Non-Life Insurers

Insurers writing Class 2 and Class 3 lines of insurance (casualty, fidelity, surety, fire, and marine) in Illinois are of five types: farm mutuals, advance-premium mutuals, reciprocals, stock companies, and Lloyds. Table 2 shows the amount of premiums written in 1961 in Illinois by each of these types of insurers.

Each of these types of insurers may be described briefly.

In 1961, 194 farm mutual insurance companies with aggregate assets of $16,815,038 operated in Illinois. Making up the total were seven special act companies with admitted assets of $1,315,206, and assessments and fees of $270,604,248; 82 county mutual fire companies with admitted assets of $6,262,457, and assessments and fees of $2,070,880; 95 township mutual fire companies with admitted assets of $3,865,048 and assessments and fees of $1,110,743; and ten District Mutual Windstorm companies with admitted assets of $5,372,327, and assessments and fees of $2,648,984.

Farm mutuals, as the name implies, engage, for the most part, in the writing of fire insurance on farm property. One of several plans of operation are used by farm mutuals: (1) They may issue the policy, charging only a small policywriting fee, and as the need arises assess each member for his share of the funds necessary to pay expenses and claims. (2) They may issue the policy, charging a cash premium large enough to pay expenses and small losses. To provide for large losses, the members are required to give premium notes to be paid when and if losses and expenses exceed the fund provided by the small advance premiums. Liability of the members is limited to the amount of these notes. (3) They may issue the policy, charging a cash premium large enough to pay expenses and small losses. If additional funds become necessary to pay claims and expenses, the members

TABLE 2

Premiums Written in Illinois in 1961 by Admitted Non-Life Insurers

Type of Insurer	Domestic	Foreign	Alien	Total
Farm Mutuals	$ 6,220,995	$	$	$ 6,220,995
Advance-Premium Mutuals	136,184,909	102,935,359		239,120,268
Reciprocals	24,334,314	10,272,698		34,607,012
Stock Companies	167,167,471	469,313,150	35,926,163	672,406,784
Lloyds		57,948	7,433,781	7,491,729
Total	$333,907,689	$582,579,155	$43,359,944	$959,846,788

SOURCE: Compiled from tabular numbers 1 and 2 of the Summary of Annual Statements prepared by the Illinois Director of Insurance, 1962.

are subject to unlimited assessment to provide these funds. Most farm mutuals operate under this last plan.

The seven Special Act companies were organized during the years 1855 to 1869 under special charters from the legislature to operate an assessment mutual fire insurance business. The county, township, and district mutual companies were organized under the general statutes of Illinois.[2] County mutual fire insurance companies may be organized by not less than 25 people living in the same county who collectively own not less than $100,000 of property which they want insured. After a county mutual is organized, the charter can be amended to include additional counties adjoining the county of origin. A township mutual requires that the persons organizing the company be from not less than three nor more than 50 adjoining political or congressional townships. A district mutual windstorm company requires at least 50 persons residing in any district of not less than three nor more than 40 counties in the state who shall collectively own property of not less than $100,000 in value which they desire to have insured.

In 1961, 152 advance-premium mutual non-life insurers did business in Illinois. Of this total, 54 were domestic and 98 were foreign. These companies charge in advance premiums that are assumed to be sufficient to pay all claims and expenses and to strengthen surplus. Frequently, the size of the premium is arranged so that a refund, called a policy dividend, can be returned to the policyholder. Most of the larger mutuals charge an advance premium quite close to that charged by the stock companies. A great many, however, charge a considerably lower premium than do other insurers, and make no refund. A few instances can be found where advance premium mutuals charge the stock company rate and make no refund.

Sometimes, of course, an advance premium mutual suffers losses in excess of those assumed in calculating the premium. In this event, some of the companies levy assessments against policyholders. Mutual companies having a surplus equal to less than the minimum capital and surplus required for a stock company transacting the same kind or kinds of business may not issue policies without contingent liability. This contingent liability must be for an amount not less than one nor more than ten times the specific premium stated in the policy.

Included in the 152 advance-premium mutuals are seven factory mutual insurance companies which wrote an aggregate of $12,064,111 in premium in Illinois in 1961. Factory mutuals charge an advance premium that is many times larger than the amount estimated to be required for payment of claims and expenses. At the end of the policy period, a large "dividend" is returned to the policyholder—or rather, is deducted from the premium charged for the subsequent policy period.

Thirteen domestic and 20 foreign reciprocal (inter-insurance) exchanges operated in Illinois in 1961. A reciprocal exchange is composed of

[2] Ill. Rev. St. 1955 (S. H. A.) Chapter 73 204.2.

a group of persons or corporations who exchange contracts of insurance through an attorney-in-fact. The exchange, unlike the mutual insurance corporation, issues no policies. It simply furnishes the mechanism for individual members (called subscribers) to insure one another. The reciprocal is not a corporation. Subscribers are individually and not jointly liable for losses. Most reciprocals issue policies which are both participating (subscribers participate in profits or savings) and assessable (subscribers assume a liability for additional premiums if funds are needed to pay losses). Some reciprocals, usually those writing automobile insurance, issue nonassessable policies at net rates under which no dividends are paid to and no contingent liability is assumed by the insured. In order to qualify to issue nonassessable policies, reciprocals, like mutuals, must have a surplus equal to the minimum capital and surplus required of stock companies writing the same lines of business.

Fifteen domestic, 282 foreign, and 54 alien stock non-life insurance companies did business in Illinois in 1961. The nature of stock insurance companies has already been explained in connection with the discussion of legal reserve life insurance companies.

One foreign (Lloyds, New York) and one alien (Underwriters at Lloyd's, London) Lloyds organization operated in Illinois in 1961. The Underwriters at Lloyd's, London, are part of the oldest insurance organization in the world today having originated in 1688 as an informal group of marine insurance underwriters who along with shipowners and foreign traders congregated at Edward Lloyd's Coffee House. Those who wanted marine insurance would write a proposal on a sheet of parchment, stating the name of the ship, its owner, its captain, its cargo, its destination, and the amount of insurance desired. Then they would take a coffee break and place the proposal on a sideboard, and go about their business of drinking coffee while the underwriters looked at the proposal and made up their minds how much of the risk, if any, they were willing to assume.

Lloyd's of London has developed not as an insurance company but as an association of individuals who write insurance for their own account. The Lloyd's Corporation provides a hall as well as the procedures for bringing the underwriters together with their clients. The Underwriters at Lloyd's, London, are admitted to do business in Illinois and Kentucky. In all other states, Lloyd's of London must operate exclusively in what is known as the surplus line market, that is, they are allowed to write insurance only on risks which admitted insurers are unwilling or unable to handle.

Underwriting is done by individuals in the United States through American Lloyds Associations, only one of which operates in Illinois. Lloyds, New York, was organized in 1892 and presently includes five underwriters with three of them assuming 90 percent of the liability. Lloyds organizations differ from other proprietary insurers in that they are not incorporated.

STATE TAXATION OF INSURANCE COMPANIES

The Premium Tax

"Legislators early saw the extensive liquid assets of insurance companies as a ready source of considerable tax revenue . . . Soon after national independence, the new state of Massachusetts reinstituted the infamous stamp tax, and in 1785 placed an imposition of two shillings on each policy of insurance, for the express purpose of reducing the war-born public debt. In 1818 the charter of the Massachusetts Hospital Life Insurance Company provided that a third of the net profits should go to the Massachusetts General Hospital, in return for a monopoly of the life insurance business in the state."[3]

"In 1814, as a result of war-time hostility to British insurance interests, a New York statute forbade aliens to engage in the fire insurance business in New York. In 1824 a 10 percent gross premium tax was placed on out-of-state fire insurers; in 1829 both statutes were extended to cover marine insurance. Such discriminatory taxation produced a heavy concentration of the New York fire insurance business in local companies, and in 1835 conflagration wiped out most of the New York companies. The 1837 legislature then reduced the tax to a realistic 2 percent, nicely balancing the protective and revenue purposes. In 1849 the tax became a 2 percent levy payable by out-of-state corporations on fire premiums, to the fire departments of the cities and towns where the insured property was located."[4]

The premium tax remains the most important method of state taxation of insurance companies. Both the tax rate and the tax base vary widely among the states. Furthermore, the rate within a given state may not be uniform for all companies or for all lines.

The Tax Rate

Domestic insurers receive favorable premium tax treatment in some states. For example, in 13 states the premium tax levied on domestic companies is less than the premium tax imposed upon foreign and alien insurers. In another ten states, only foreign and alien companies are required to pay a premium tax. In one state (Alaska) domestic companies are given a premium tax-free period of five years from date of organization. In Kentucky only domestic life insurers and in Pennsylvania only domestic fire and casualty insurers are exempt from the premium tax. Connecticut, however, presents a reverse exception: domestic insurers are required to pay a premium tax higher than foreign and alien insurers, 2½ percent on life insurance premiums, and 2¾ percent on fire and casualty insurance premiums as compared with 1¾ percent on life premiums and 2 percent on fire and casualty premiums required of foreign and alien companies. The retaliatory laws found in most states gave the necessary encouragement to Connecticut,

---

[3] Spencer L. Kimball, *Insurance and Public Policy,* Madison: The University of Wisconsin Press, 1960, p. 251.
[4] *Ibid.*

a large exporter of insurance, to keep the tax rate lower for non-domestic insurers.

The premium tax rate varies in some states as to lines of insurance, and when this is true there is no uniformity as to the direction of the variance. For example, as mentioned, in Alabama fire and marine insurance premiums are taxed at 2½ percent whereas premiums for life and casualty insurance are taxed at 3 percent. In Michigan, however, fire and marine insurance premiums are taxed at 3 percent whereas premiums for all other lines are taxed at 2 percent. Furthermore, in Arkansas life and health insurance premiums are taxed at 2½ percent whereas all other premiums are taxed at 2 percent. But in New York life insurance premiums are taxed at 1¾ percent whereas all other premiums are taxed at 2 percent. Louisiana taxes fire and marine premiums at a higher rate than casualty and surety premiums, and casualty and surety premiums at a higher rate than life insurance premiums. In nine states, annuity premiums are taxed at a lower rate. Three states exclude premiums on qualified pension plans from the premium tax and one state taxes these premiums at a lower rate.

In ten states a reduction in the premium tax rate is allowed if a certain percentage of the insurer's assets are invested in the state. For example, in Colorado the premium tax is 2¼ percent unless 30 percent of the assets of the insurer are in the state in which case the rate is only 1 percent. Georgia taxes premiums at the rate of 2¼ percent unless at least one-quarter of the insurer's assets exclusive of direct obligations of the U.S. are invested in specified Georgia public and corporate securities, property subject to taxation by Georgia or its political subdivisions, and loans secured by liens on either Georgia real estate or life insurance policies on Georgia residents, in which case the rate is reduced to 1¼ percent. In New Mexico, if one-half of the insurer's assets are domestic, the premium tax is three-quarters percent; otherwise, it is 2½ percent. In Louisiana the tax is reduced one-third if one-sixth of the assets of the insurer are in Louisiana securities.

The premium tax rate varies among the states. Using the rate imposed upon foreign life insurers for illustration, the range is a high of 4 percent in Oklahoma and a low of 1.7 percent in Louisiana. The most common rate is 2 percent, found in 24 states including the District of Columbia. Of the remaining 25 states, three have a rate of 1¾ percent; six, 2¼ percent; one, 2.35 percent; eight, 2½ percent; six, 3 percent; and one, 3.3 percent. But because the rates are not applied uniformly to the same base in all states and because tax offsets allowed vary widely, it is necessary to look beyond the rate itself for an adequate comparison of premium taxes among the states. Furthermore, various "in lieu of provisions" among the states must be taken into consideration.

The Tax Base

The premium appearing in the policy will not necessarily be the taxable premium in every state. In reporting total premiums collected the statutes

express the taxable premiums in terms of premiums collected, premiums received, premium receipts, premiums collected or contracted for, new and renewal gross premiums, or premiums written. For tax purposes, all states allow premiums returned on policies not taken or rescinded to be eliminated from the total. This is accomplished either by allowing "returned premiums" as a deduction or simply by not requiring the returned premiums to be included in the reported gross premium figure.

Reinsurance premiums (payments by one insurer to another for acceptance of part or all of the risk written by the original insurer) also are not included in the tax base. This is achieved in most states by requiring only direct premiums to be reported. In other states, insurers are required to report reinsurance premiums received but are allowed to deduct them in computing the tax base. In some of these states, only those reinsurance premiums collected from unlicensed companies have to be accounted for whereas in other states the accounting is for only those reinsurance premiums collected from licensed companies.[5] Most of the states with statutes requiring the reporting and deducting of reinsurance premiums accept tax returns on which only direct premiums are reported in order to reduce administrative work for the insurer and the tax authorities.

An important variable in the tax base among the states is the way in which dividends to policyholders are handled. In most states, the insurer is allowed to take a deduction from the tax base for policyholder dividends. They are viewed as a refund to the policyholder of that part of the premium not needed by the insurer for the safe operation of the company. The practical effect of allowing a deduction for dividends is to eliminate discrimination against insurers issuing participating policies and to eliminate discrimination in favor of insurers who sell at a low initial rate by giving the insured his dividend in advance.

Thirteen states do not allow dividends paid on life insurance policies to be deducted from the premium tax base. Another (Wisconsin) does not allow a deduction for dividends on paid-up life policies. Eight of these 14 states do not allow a deduction for dividends paid on fire and casualty insurance policies. Another of these states allows a deduction of policy dividends on fire lines only.

With one exception, in states where a deduction for life insurance policy dividends is allowed, dividends used to purchase paid-up additions or to shorten the endowment or premium paying period must be included in the tax base. The one exception is Texas where dividends applied to purchase paid-up additions are both excluded and deducted. Again with one exception, where a deduction for life insurance policy dividends is not allowed, dividends applied to purchase paid-up additions or to shorten the

[5] A number of states taxed reinsurance premiums collected from licensed or unlicensed companies, either or both, until the United States Supreme Court decided the case of *Connecticut General Life Insurance Company* v. *Johnson* (1938), 303 U.S. 77; 82 L. ed. 673; 58 S. Ct. 436. In this case, the Court held that California could not tax reinsurance premiums either as laid on property, business done, transacted, or carried on within the state, or as a tax on a privilege granted by the state.

endowment or premium paying period need not be added to the tax base. Curiously, Kentucky allows no deduction for dividends but still requires dividends used in one of the above manners to be added to the tax base.

Fifteen states exclude ocean marine insurance premiums from the premium tax base, electing to tax ocean marine insurance underwriting profits instead.

Another important variable in the tax base is the treatment of premiums paid for annuity contracts. Nine states, it will be recalled, tax annuity premiums at a lower rate than life insurance premiums. In another 24 states annuity considerations are not considered premiums for tax purposes and, therefore, are not included in the base. Among the 26 states plus the District of Columbia where annuity considerations are taxable as premiums, 20 allow a deduction for termination allowances on group annuity contracts. This means that when an employee who has made contributions under a contributory retirement plan, or for whom the employer has made contributions under the plan, ceases to be a member of the covered group before his retirement, the insurer may deduct that amount which it must refund to such employee, his beneficiary, or his employer by reason of such cessation. The maximum amount deductible is the employee's and employer's total contributions under the plan. The insurer may also exclude from gross direct premiums any credit allowed to the employer which is applied to reduce subsequent annuity considerations rather than being paid in cash, up to the same maximum amount.

A number of other interesting variations in the tax base are found. Hawaii allows cash surrender values paid on life insurance policies to be deducted from the tax base. Idaho, Massachusetts, Rhode Island, and Vermont require domestic companies to include in their tax base direct premiums in other states and countries on which no tax is paid or payable. Indiana allows as a deduction from the tax base all losses actually paid within the state except life insurance proceeds. In Kansas no premium tax is paid on workmen's compensation insurance premiums if the maintenance fund to which this tax is credited exceeds $300,000 on June 30 of the year in which the tax is payable. Domestic companies in Maine do not have to include in their tax base premiums on insurance issued on farm property.

Taxable premiums in New Jersey are limited to 12½ percent of the company's total premiums both within and outside of New Jersey. New York requires alien companies to include premiums written, procured, or received in New York in their tax base if these premiums are not allocated and reported as taxable in another state. Domestic companies in South Carolina are taxed at the rate of 2 percent on premiums, but the amount of the premium tax payable is limited to 5 percent of the net income reported under the South Carolina Income Tax Act of 1926, as amended. First year premiums on life and health insurance are not included in the tax base in

Texas. Domestic companies in Wisconsin are not required to include health insurance premiums in their tax base.

Premium Tax Offsets

Several states allow offsets against the premium tax. Alabama allows foreign and alien companies credit for ad valorem taxes paid upon Alabama real estate and improvements owned and at least 50 percent occupied by the company for the full period of such tax year. California allows all companies to offset the premium tax with real estate taxes paid on the home or principal office in the state. Florida allows a reduction of 50 percent in the premium tax and credit for all ad valorem taxes on such property if a foreign or alien company maintains a regional home office in the state to service three or more states, subject to a maximum offset of 80 percent of the premium tax. Utah allows an offset for all property taxes paid for general state purposes and any fee for examination. Domestic insurance companies in Mississippi may deduct the total ad valorem tax on real estate paid by such company in the State of Mississippi during the preceding calendar year up to the amount of $20,000.

Illinois, New York, and New Jersey allow the amount of the fire department tax paid to be taken as an offset against the premium tax. In addition, New Jersey permits a graduated deduction of certain franchise and personal property taxes. Colorado permits an offset of $75 of the company's license fee. The amount of the annual license fee for each class of business is allowed by Nevada as an offset against the premium tax if this fee is less than the premium tax. Examination and valuation fees are allowed as a credit in Texas. Tennessee allows the valuation fees paid on life insurance policies to be deducted from the premium tax. Maryland allows domestic companies credit for the franchise tax. Missouri allows all companies to deduct income taxes, franchise taxes, personal property taxes, valuation fees, registration fees, and examination fees paid under Missouri state law.[6] In Wisconsin, taxes paid on personal property owned by the insurer and used on any farm may be deducted from the premium tax. Payments required by the State of Florida for administering the Workmen's Compensation law may be credited against the tax on workmen's compensation premiums. The Idaho special tax on workmen's compensation premiums may be offset against the premium tax.

"In Lieu of" Provisions

In the majority of states the premium tax is in lieu of some other tax or taxes. Fourteen states provide that the premium tax shall be payment in full and in lieu of all other state and local taxes except those on real and tangible personal property located within the state. In five states, the premium tax is in lieu of all other taxes except those upon real property owned in the state. Other states make the tax in lieu of local license fees and

[6] If the examiner under the zone system of examinations is not from the Missouri Insurance Department, no credit is allowed.

privilege tax upon the company and in some states also in lieu of any other state or local taxes on the premium. In one state, the premium tax is in lieu of all other state as well as local licenses and fees of every kind and character. Various other "in lieu of" provisions are found such as: (1) in lieu of all other taxes except franchise and excise taxes and taxes on real and personal property and fees provided by the insurance laws; (2) in lieu of any franchise or capital stock tax; (3) in lieu of all county or city taxes except real and tangible personal property taxes and capital stock tax on domestic companies; (4) in lieu of all license and privilege taxes and all taxes of whatever kind except taxes upon real estate, the state income tax, and sales and use taxes levied upon tangible personal property; (5) in lieu of any other intangible tax; (6) in lieu of personal property tax and income taxes; (7) in lieu of county license fees and taxes; and (8) in lieu of all other taxes, except taxes on real and tangible personal property and excise taxes on the sale, purchase, or use of such property.

Thus with four variables (rate, base, offsets, and "in lieu of" provisions) the task of comparing the relative tax burden placed on insurers by the various states becomes Herculean.

The Franchise Tax

Eight states impose a franchise tax on domestic insurers only; three impose the tax on all companies, and one state imposes the tax on all companies except foreign fire insurers and alien casualty companies. The tax base in one state is different for domestic companies than for foreign and alien companies. The tax is called a privilege tax in one state, a corporation license tax in another, and a capital stock tax in still another state. Both the tax rate and the tax base vary widely among the states. For example, Alabama levies a ¼ percent tax on all companies. The tax base for domestic companies is the paid-in capital stock; for foreign and alien companies it is the actual amount of capital employed in Alabama after deduction of mortgages on Alabama real estate.

New Jersey imposes a franchise tax on domestic companies only, and the rate is 2 percent based on taxable premiums. The franchise tax may be taken as an offset against the premium tax, and no county or taxing district shall levy any other tax upon any company or its assets except upon real estate and tangible personal property located in the state. Eighty-seven and one-half percent of the tax is paid to the taxing district and 12½ percent to the treasurer of the county in which the home office is domiciled.

Michigan imposes a franchise tax on domestic companies, but does not impose the premium tax on these companies. The franchise tax, called a privilege tax, is ½ percent of the paid-up capital and unassigned funds. Unassigned funds are defined as the excess of net admitted assets over paid-up capital, reserves, and other liabilities required by law or regulation of the insurance commissioner. The minimum tax is $10, and the maximum is $50,000. Companies operating outside of Michigan use as the tax base the

ratio that net Michigan premiums bear to total net premiums written, but in no event less than 15 percent. This tax is in lieu of all other privilege or franchise fees or taxes imposed by any other law of the state except real and personal property taxes.

Maine has a graduated franchise tax and it applies to Maine companies only: Ten dollars for $50,000 or less of authorized capital to $100 for authorized capital of between $500,000 and $1,000,000, and $50 for each additional $1,000,000 or fraction. On shares of no par value, the tax is from $10 on 250 shares or less to $100 when such shares are between 5,000 and 10,000, and $50 for each 10,000 shares or fraction.

Arkansas levies a franchise tax against all companies: $100 if outstanding capital stock is less than $500,000 and $200 if it is $500,000 or more. Delaware taxes domestic companies only. The basis of the tax is the authorized shares of capital stock. A graduated scale is used: not exceeding 250 shares, $5.50; between 251 and 1,000 shares, $11.00; between 1,001 and 3,000 shares, $22.00; between 3,001 and 5,000 shares, $27.50; between 5,001 and 10,000 shares, $55.00; for each additional 10,000 shares, $27.50 with a maximum of $100,000.

In New York, the franchise tax base is the direct gross premium (except ocean marine) less return premiums written during the preceding calendar year on New York risks after deducting dividends to policyholders. The rate is ½ percent for alien fire companies, 1 percent for foreign casualty companies, and 2 percent for domestic companies.

These few examples should be enough to illustrate how the tax rate and tax base vary among the 12 states imposing special franchise taxes on insurance companies.

Income Taxes

Twelve states impose an income tax on insurance companies. (Two of these states call the tax an excise tax.) Seven of these states restrict the tax to domestic companies. Where foreign and alien insurers are taxed, these companies pay the tax only on the income earned in and apportioned to the taxing state. Except for three states, domestic companies do not pay taxes on income earned outside the state. In one of these atypical states, only that income earned outside the state and not taxed under an income tax levied by another state is taxable by the home state.

Here again the tax rate and tax base vary widely among the states. To illustrate: Alaska simply taxes all companies at the rate of 18 percent of the total Federal income tax which would be payable under the 1954 code, as amended, on all income apportioned to Alaska. Pennsylvania levies a 6 percent tax on the portion of the taxable income reported to the Federal Government that premiums on Pennsylvania risks bear to the over-all premiums. This tax does not apply to companies taxable under the Pennsylvania Corporate Net Income Tax Act. Minnesota taxes all companies 7½ percent (10.23 percent in 1962) of the net income on Minnesota business

in excess of $500. A credit is given for premium taxes paid. Oklahoma taxes domestic companies 4 percent of net income from all property owned and from business transacted in Oklahoma during the preceding calendar year. Indiana taxes domestic companies 1½ percent of gross income (as defined) in excess of $1,000 from all sources, but excluding income used to maintain policy reserves and premiums derived from sources outside the state on which a premium tax of 1 percent or more has been paid. Arkansas taxes domestic companies on the basis of their entire net income as defined. The tax is graduated: 1 percent on the first $3,000; 2 percent on the next $3,000; 3 percent on the next $5,000; 4 percent on the next $14,000; and 5 percent on all in excess of $25,000.

Ocean Marine Underwriting Profits Tax

Ocean marine insurance premiums are excluded from the premium tax base in 16 states, with one of these, Connecticut, excluding these premiums in the tax base of foreign and alien companies only. The purpose of these exclusions is to allow marine insurers to compete in the world market without the burden of a tax loaded into the premium. All of these states, however, except Connecticut, tax the underwriting profits from ocean marine insurance. Three of them (Arkansas, Florida, and Oregon) tax the ocean marine underwriting profits of foreign and alien companies only. Some uniformity is found in the tax rate and tax base used. Five states (Arkansas, Florida, Hawaii, Montana, and Washington) tax gross underwriting profits at ¾ percent. Gross underwriting profits are determined by subtracting from gross premiums all returned premiums, premiums for reinsurance ceded, and net losses paid during the calendar year. Ten states (California, Massachusetts, Minnesota, New Hampshire, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, and Utah) levy a 5 percent tax on what is called taxable underwriting profit. The tax base is a percentage of the average annual underwriting profit on ocean marine insurance written in the United States during the last preceding three calendar years. The percentage applied is computed by dividing the average annual ocean marine net premiums written in the state by the average annual amount of all such premiums written in the United States both during such period.

Special Fire Insurance Taxes

The majority of states have some form of special tax on fire insurance premiums for support of the office of the State Fire Marshall or to support local fire departments. Some states levy both a fire marshall and a fire department tax. Nineteen states have a fire marshall tax. In a 20th state (Texas) a fire marshall tax was declared unconstitutional. One of these states (Indiana) imposes the tax only on foreign and alien companies and another (North Dakota) applies the tax to domestic companies only. Nebraska discriminates between out-of-state companies and domestic companies by charging domestic companies a rate of ¼ percent while charging foreign and alien companies ½ percent. The tax rate fluctuates between a

high of 1 percent in Louisiana to a low of 1/10 percent in South Carolina. The most common rate is ½ percent found in 11 states. The remaining six states levy a tax as follows: one, ¼ percent; one, 5/16 percent; one, 1/3 percent; one, 3/8 percent; and two, ¾ percent. The tax base also has some slight variation among the states. For example, the base in Indiana is the net premium on fire and automobile fire lines including 35 percent of the homeowners premium, 35 percent of the commercial property insurance premium, 15 percent of the inland marine insurance premium, and 4 percent of the automobile insurance premium. The base in West Virginia (which has a rate of ½ percent like Indiana) is the net premium from fire or the fire portion of other insurance, 40 percent of the homeowners premium, 15 percent of ocean and inland marine premiums, and 5 percent of automobile insurance premiums.

About one-half of the states provide for a contribution to the local fire departments either by a special levy for this purpose or by allocating premium tax receipts among the departments. In a few states, municipalities have the authorization to levy a fire department tax. For example, Arizona, Arkansas, Idaho, Montana, North Dakota, Oklahoma, South Dakota, Vermont, and Washington allocate all or part of the fire insurance premium tax to local fire departments. Alabama, Florida, Missouri, and Nebraska specifically allow the municipalities the right to levy a tax on fire insurance premiums to support the local fire department or to fund pensions for firemen.

Twelve states levy a specific fire department or firemen's pension or relief tax. In eight of these states the tax applies to all companies writing fire lines. Four states restrict the tax to foreign and alien companies. In three states, the fire department tax may be taken as a credit against the premium tax. In one state, the fire department tax is levied as an additional tax on domestic companies, but may be taken as an offset against premium taxes by foreign and alien companies. In the remaining eight states, no credit is given on the premium tax for the fire department tax. The "tax" in one of these states is called a firemen's relief fund surcharge, and this charge is not subject either to agents' commissions or to the premium tax. North Carolina has a Fire Department (firemen's relief) tax and a Firemen's Pension Fund tax. The North Carolina Supreme Court in 1957 held the pension fund tax unconstitutional.[7] The tax was revised in 1959 and is currently under litigation. Seven of the twelve states with a fire department tax also have a fire marshall tax.

Two percent is the most common fire department tax rate with this rate found in eight states. In two states the rate is 1 percent, and in the other two states the rate is 1½ and ½ percent. The rate is usually applied to the total premiums on all fire lines and fire portions of other lines received in qualifying taxing districts (city or fire district).

[7] *American Equitable* v. *Gold*, 249 N.C. 461, 106 SE 2d 875.

Special Workmen's Compensation Insurance Taxes

A number of states impose special taxes or assessments on insurers writing workmen's compensation insurance. The purpose of these assessments is to offset the cost of administering the workmen's compensation system to build security funds, and to finance second-injury funds designed to facilitate the employment of physically handicapped workers. The second-injury funds in California and Pennsylvania are supported by legislative appropriations. In Ohio, North Dakota, and West Virginia the state workmen's compensation funds take care of the cost of second injuries.

Special assessments or taxes to offset the cost of administration of workmen's compensation laws or to finance security funds are found in 18 states. In five of these states, the levy on workmen's compensation premiums is in lieu of the regular premium tax. Among these five states, three states charge a higher rate on workmen's compensation premiums than on other premiums: Delaware and Florida impose a 4 percent tax and South Carolina levies a 4½ percent tax. These rates compare with 1¾ percent in Delaware for other lines, 2 percent in Florida, and 2 percent for domestic insurers and a maximum of 3 percent for out-of-state companies in South Carolina. Kentucky charges the same premium tax for workmen's compensation insurance as for other lines (2 percent) but stipulates that no tax is to be paid if the maintenance fund to which this tax is credited exceeds $300,000. Virginia taxes workmen's compensation premiums 2½ percent (compared with 2¾ percent for other lines) and further provides that if the tax collected exceeds total expenses chargeable to the workmen's compensation administrative fund, the Industrial Commission may authorize a credit or refund.

Thirteen states have an assessment or tax on workmen's compensation insurers which is in addition to the regular premium tax. Included in this group is North Carolina which not only taxes workmen's compensation premiums 4 percent for out-of-state insurers and 1.6 percent for domestic insurers (compared to 2½ percent and 1 percent respectively for other lines) but also taxes stock workmen's compensation insurers at the rate of 1 percent of workmen's compensation premiums until a workmen's compensation security fund is built up in an amount equal to 5 percent of the workmen's compensation loss reserves of all stock insurers. Pennsylvania, Wisconsin, New Jersey, and New York have similar stock workmen's compensation security funds calling for the same tax rate. The maximum additional tax on workmen's compensation premiums is 3 percent in Arkansas and Montana, 1 percent in Minnesota, and ¼ percent in New Jersey and Texas. The Minnesota tax is to be assessed only if it is necessary to pay workmen's compensation awards unpaid because of insolvency of an insurer.

Georgia, Kansas, Maryland, Mississippi, and New York assess workmen's compensation insurers annually to pay the cost of administering the act. No maximums are specified. The expenses of administration are pro-

rated among the insurers (and self-insurers in Kansas and Mississippi) writing the coverage in the state. The assessment is prorated in proportion to earned premiums in Georgia, in proportion to payroll covered in Maryland, and according to benefits paid in Kansas, Mississippi, and New York.

Thirty-nine states including the District of Columbia levy a second-injury fund tax on workmen's compensation insurers. The assessment may be based on death cases incurred imposing a liability, no-dependency death cases, all compensation paid, premiums written on workmen's compensation insurance in the state, the number of cases of loss or total impairment of a body member, total disbursements from the fund during the preceding year, or some combination of the above bases. The most often used base is no-dependency death cases with 22 states using this base. Eleven of those states combine this base with some other base. The amount assessed ranges all the way from \$300 per case to \$6,250 per case.[8] The most common assessment for no-dependency death cases is \$500 with ten states charging this amount. Of these states, four use an additional base: New Hampshire assesses \$15 in each scheduled injury case; South Dakota, ½ percent of workmen's compensation benefits paid; Massachusetts, the balance of schedule injury benefits when employee dies without leaving specified survivors; and Mississippi, \$150 in compensable death cases.

Four states base contributions to the second-injury fund on premiums written on workmen's compensation insurance: Florida and Delaware, ½ percent; Kentucky, ¾ percent; and Rhode Island, 1 percent. In addition, Rhode Island charges \$750 in each no-dependency death case. Eight states base contribution on total compensation paid: Connecticut, Idaho, New Jersey, and New Mexico, 1 percent; Indiana, Michigan, and South Dakota, ½ percent; and Missouri, ¼ percent. In addition, New Mexico charges \$1,000 and South Dakota \$500 for no-dependency death cases.

Seven states require contributions on the basis of compensable death cases. Of these seven states, only Alabama restricts the contribution to this base, charging \$100 for every death case imposing a liability. Massachusetts in addition to its charges mentioned above assesses \$500 in every death case for a special veterans' second-injury fund. Maryland and Tennessee charge \$100 for all compensable death claims plus \$10 for each permanent partial disability case. Iowa charges \$100 for compensable death claims plus 50 percent of benefits paid to non-resident alien dependents. Mississippi assesses \$150 for all compensable deaths plus \$500 for no-dependency deaths. Illinois charges \$400 for compensable death cases plus \$200 in cases involving loss of members. Other states assessing for loss of members are North Carolina (\$100) and Wisconsin (\$1,500). In North Carolina the \$100 loss of member tax is in addition to \$100 in no-dependency death cases whereas the \$1,500 Wisconsin tax is the sole contribution to the second-injury fund.

[8] Minnesota charges \$300 in no-dependency death cases but also charges 2 percent of all awards in permanent partial disability cases. Colorado assesses \$6,250 for no-dependency death cases.

The second-injury fund contribution in New York is based on the total disbursement from the fund during the preceding year, each insurer contributing in proportion to its total compensation payments. In addition to the second-injury fund, New York requires a contribution of $500 for each no-dependency death case for vocational rehabilitation.

In 20 states, payments to the second-injury fund are suspended when the fund grows to a stated maximum or bears a stated relationship to the fund's liabilities. Some maximums, for example, are $1,500,000 in New Jersey; $500,000 in Florida and Rhode Island; $250,000 in Illinois; $200,000 in Kentucky, Michigan, and Oklahoma; $100,000 in Maryland and Alaska; $50,000 in Connecticut, Indiana, Iowa, and Kansas; $35,000 in Mississippi (partial suspension); and Delaware $30,000. In Texas and South Dakota suspension of payments is made when the fund reaches $100,000 in excess of liabilities. Payments in New Hampshire were suspended July 1, 1959, to July 1, 1963 (Ch. 194, Laws, 1961). In Montana, the Industrial Accident Board has the power to suspend payments when it has a sufficient surplus in the fund over known liabilities.

Annual Fees

Various fees are charged by the states for filing annual statements, company licenses, and agents' licenses. These fees, like all other taxes and charges assessed against insurance companies vary widely among the states. Most of these fees are low. Company licenses vary from no cost at all to $400. The agents' license fees run as high as the $250 non-resident license fee in Alaska to as low as 50 cents for agents of domestic companies in Iowa and South Dakota. Kansas charges non-domestic companies a school fund fee of $50 a year.

Other Special Insurance Taxes

New York, Texas, and Virginia impose assessments on insurers to offset the cost of operating the state insurance department. In New York, domestic insurers and U.S. branches of alien insurers domiciled in New York may be assessed annually by the Superintendent to pay the excess of insurance department expenses over the amount of fees (excluding taxes) collected. The assessment is in proportion to the gross direct premium written or received by the insurers in New York. Texas and Virginia apply the tax to all companies but limit the amount that can be assessed in any year. The limit in Texas is based on lines (fire, for example, 1¼ percent and casualty 2/5 percent of gross direct premiums written in the state) whereas in Virginia the maximum is 1/10 percent of gross premiums on business done in the state regardless of line.

Louisiana assesses all companies writing lines subject to the rate regulatory law in proportion to the gross premiums written on these lines in Louisiana but not exceeding 1 percent of these premiums. To pay the expense of administering the casualty rating law Mississippi assesses on a pro

rata basis all companies writing these lines. Total contributions of all companies are limited to $35,000 in any one year.

New Jersey assesses all companies writing motor vehicle liability policies or bonds on New Jersey risks on a pro rata basis for the purpose of defraying the cost of administering the motor vehicle security responsibility law. Two other assessments are made on automobile liability premiums on New Jersey-garaged automobiles: 1 percent to build a motor vehicle liability security fund to an amount equal to 5 percent of net direct premiums of all insurers for the highest of the past three calendar years; and a pro rata contribution (maximum 1 percent) to make up any estimated deficiency in the motor vehicle unsatisfied claim and judgment fund. New York assesses the concerned insurance companies pro rata to pay the cost of administering the Disability Benefits law, the Motor Vehicle Safety Responsibility Act, Motor Vehicle Financial Security Act, and the Motor Vehicle Accident Indemnification Corporation. In addition New York assesses all stock insurers writing public motor vehicle liability insurance 1 percent of direct gross premiums written on these policies until the Stock Public Motor Vehicle Liability Security Fund equals 15 percent of outstanding claims reserves incurred under these policies. A similar assessment is made on all companies writing motor vehicle liability insurance to fund the Motor Vehicle Liability Security Fund.

Connecticut has an interest and dividends tax applying to domestic companies only, under which these items, less specified deduction, are taxed at a diminishing rate: 2 3/8 percent in 1962 down to ¼ percent in 1971 and no tax thereafter.

Local Taxes

About 50 percent of the states pre-empt the field of insurance company taxation. Some state statutes remain silent on the subject. About 30 percent of the states specifically authorize local governments to levy license fees or occupation taxes. In some of these states eligibility rules are established and the kinds and maximums amounts of tax are specified.

Retaliatory Taxes

Forty-two states have retaliatory laws applying to insurance company taxation. In one of these states, the law does not apply to alien companies. In effect these laws say that if companies domiciled in this state are required to pay a tax in another state higher than the tax set up in this state for out-of-state companies, then companies domiciled in such state and doing business in this state will be required to pay the same higher tax to this state. The excess tax produced by the application of this feature is called a retaliatory tax, and serves as a means of controlling the urge to raise taxes on out-of-state companies.

In applying the retaliatory law, not only must the premium tax rate be taken into consideration but also the tax base and tax offsets as well as other special state taxes must be considered. Nearly half the states specify

that any tax, license, or other obligation imposed by any city, county, or agency of such other state or country shall be deemed as imposed by the state. Enforcement of retaliatory laws is mandatory in nearly every state. Colorado, Kentucky, and Washington, however, are exceptions. Enforcement in these states is optional with the insurance commissioner. In Indiana, retaliation is mandatory only against companies domiciled in states which retaliate against Indiana companies. California retaliates only against companies domiciled in states which discriminate against foreign and alien companies in favor of home companies. Vermont does not retaliate against companies domiciled in states in which no Vermont company is licensed. The Wyoming retaliatory law does not apply to alien companies.

The retaliatory law is commonly imposed on an aggregate basis rather than an item-by-item basis. The aggregate basis is specified in the statutes of many states and by ruling of the Attorney General in others. Rulings in Minnesota, North Dakota, and Washington require the retaliatory taxes to be set off item-by-item and not in the aggregate; that is, each item must be considered separately and the highest rate applied.

TAXATION OF INSURANCE COMPANIES IN ILLINOIS

The State of Illinois imposes several types of taxes and fees on insurers. Some of these impositions are levied on foreign and alien insurers only, whereas others are assessed against domestic insurers also.

The Premium Tax

Chapter 73, numbers 1021-24, 1027 of the Illinois Revised Statutes provide for a premium tax on foreign and alien companies authorized to do an insurance business in Illinois, except fraternal benefit societies. The amount of such tax is 2 percent of the gross amount of premiums on direct business including annuity considerations received during the preceding calendar year on contracts covering risks within Illinois after deducting (1) the amount of returned premiums on policies covering Illinois risks[9] and (2) the amount returned to policyholders on Illinois risks as dividends paid in cash or used to reduce premiums.[10] The amount of the fire department tax (discussed on page 782) paid during the preceding calendar year may be deducted from the premium tax as computed.

The premium tax is in lieu of all license fees or privilege or occupation taxes levied or assessed by any municipality, county, or other political subdivision of Illinois. Therefore, no municipality, county, or other political subdivision of the State can impose any license fee or privilege or occupation tax upon any foreign or alien company, or upon any of its agents, for the

[9] Returned group annuity considerations arising from the termination of employment, withdrawal, or death of a prospective annuitant under group annuity contracts prior to retirement constitute "returned premiums" and not "cash surrender values" or "death benefits" and are therefore excludable from the tax base.

[10] By ruling of the Attorney General, dividends applied toward paid-up additions must be added to premium income before they can be deducted from the taxable base.

privilege of doing an insurance business except the tax authorized by Chapter 24, Article 11, Division 10, Number 1 of the Illinois Revised Statutes.[11] The "in lieu of" provision, however, does not prohibit state, county, and municipal taxes on real and personal property of insurance companies including the personal property tax on net agency premiums (Chapter 73, Number 1026) discussed later, or the taxes for the purpose of maintaining the office of the State Fire Marshal (Chapter 73, Number 1027) discussed below.

The Fire Marshal Tax

Chapter 127½, Number 16 provides that all companies (including domestic companies) pay a tax of up to ½ percent of the direct gross fire, sprinkler leakage, riot, civil commotion, explosion, 33 1/3 percent of homeowners and 15 percent of inland marine (including householders' personal property floater) premiums received in Illinois during the preceding calendar year, less return premiums for the purpose of defraying the expenses of the Office of the State Fire Marshal.[12] Amounts less than ½ percent may be assessed.

The Fire Department Tax

Under Chapter 24, Article 11, Division 10 all except Illinois companies may be taxed at the maximum rate of 2 percent on direct gross fire and automobile fire premiums covering property within city or fire district limits received during the year ending on July 1, less return premiums. Credit is given on the premium tax for the payment of the fire department tax. The purpose of the fire department tax is to support properly organized fire departments in those municipalities that qualify for the support.

Annual Fees

The Illinois Code provides for certain annual fees to be paid. Chapter 73, Numbers 748 and 1020 require that all companies on or before March 1 file an annual statement and pay a $50 fee. All except Illinois companies are required to pay a $5 fee for a certificate of authority at the time the annual fee is paid (Chapter 73, Numbers 725, 726). All companies must obtain annual licenses for agents and pay a fee. Foreign and alien companies pay an agent's license fee of $2 for each agent. Illinois companies pay $1 for each agent. (Chapter 73, Numbers 1065.44, .48).

Second-Injury Fund

Under the Workmen's Compensation and Occupational Diseases Acts (Chapter 48; W. C., Numbers 138.7 (f), 138.8 (e) (20); O. D. Numbers 172.42 (f), 172.43 (e) 20) all companies writing workmen's compensation insurance are required to make, on behalf of employers, contributions to the second-injury fund of $400 in all compensable death cases (proportionate re-

[11] Chapter 24, Article 11, Division 10, Number 1 deals with the fire department tax on foreign and alien fire insurance companies and will be discussed later in the body of the text.

[12] The Illinois Attorney General ruled that the fire marshal tax is payable on motor vehicle fire premiums only by companies licensed to write Class 3 (fire) lines of business and not at the same time licensed to write casualty lines (specifically, Class 2[b]).

duction in event of a compromise death settlement) and $200 in case of a loss of body member. The payments are subject to a reduction of one-half when the fund reaches $150,000. When the fund reaches the sum of $250,000 the payments shall cease entirely until the fund is reduced to $200,000 when the payments at the 50 percent rate begin again. When the fund falls below $150,000 full payments are required.

Surplus Line Tax

Chapter 73, Number 1057 of the Illinois Revised Code provides for the licensing of surplus line agents to place business with non-admitted insurers. The license fee is $100 annually for agents in counties of 100,000 or more, and $50 for those domiciled elsewhere. Surplus line agents must pay a tax of 2 percent of the gross premium written as surplus lines in non-admitted companies.

Authorization for Local Taxes

Chapter 73, Number 1026 provides that all except Illinois companies must instruct local agents to file a return of net agency receipts for the year ended April 30 from fire and marine classes of business and pay tax on this amount at the regular personal property rate as assessed where the agency is located. Return premiums and agency operating expenses (except losses) are deducted from total premiums to obtain net receipts. This tax is in lieu of all town and municipal licenses except the fire department tax.

Retaliatory Taxes

Chapter 73, Number 1056 provides that whenever the existing or future laws of any other state or county shall require Illinois companies to pay penalties, fees, charges, or taxes greater than the penalties, fees, charges, and taxes required in the aggregate for like purposes by Illinois of foreign or alien companies and their agents or brokers, then companies domiciled in such state or country and doing business in Illinois shall be required to pay penalties, fees, charges, and taxes in amounts equal in the aggregate to those required of Illinois companies and their agents and brokers doing business in such state or country.[13]

INSURANCE TAXES IN ILLINOIS vs. THOSE IN OTHER STATES

In 1960, 6.27 percent of all premiums written in the United States were written in Illinois. The share of all revenue produced in the United States by premium taxes and fees going to Illinois was 5.24 percent. Although Illinois was the fourth largest state in terms of premium volume (Table 3), and the sixth largest state in terms of total revenue produced by premium taxes and fees (Table 4), it was 45th in the percentage of premium volume received in premium taxes and fees (Table 5). The 1.47 percent of Illinois premium volume received by the state in taxes and fees was well below the national mean of 1.76 percent and median of 1.87 percent.

[13] In applying the retaliatory law, personal property taxes are not to be included in the aggregate. *Pacific Mutual Insurance Company* v. *Gerber* (1961) 174 N.E. (2d) 862.

Among the states with a lower ratio than Illinois of premium taxes and fees to premium volume received, four (New Jersey, New York, Pennsylvania, and Rhode Island) impose an ocean marine underwriting profits tax. Two states (Indiana and Pennsylvania) levy an income tax on domestic companies, and one (New York) assesses a fee for the maintenance of the state insurance department.

TABLE 3

Premium Volume, 1960

1. New York	$ 4,951,727,088
2. California	3,318,244,497
3. Pennsylvania	2,207,617,415
4. Illinois	2,121,481,217
5. Ohio	1,848,513,562
6. Texas	1,603,583,800
7. Michigan	1,470,909,331
8. New Jersey	1,408,404,376
9. Massachusetts	1,087,748.570
10. Florida	884.396,356
11. Indiana	815,000,000*
12. Missouri	761,597,371
13. Wisconsin	732,458,391
14. North Carolina	595,625,896
15. Connecticut	560,296,221†
16. Minnesota	558,475,650
17. Tennessee	539,764,129
18. Virginia	529,142,996
19. Maryland	528,566,305
20. Iowa	507,599,843
21. Washington	507,450,633
22. Louisiana	491,120,395
23. Georgia	484,044,014
24. Alabama	422,083,289
25. Kansas	385,344,843
26. Kentucky	375,422,164
27. Oklahoma	361,324,983
28. Oregon	346,321,352
29. South Carolina	341,395,367
30. Colorado	283,151,285
31. Nebraska	254,584,109
32. Arizona	237,418,998
33. West Virginia	225,313,659

TABLE 3 (Continued)

34. Mississippi	220,186,402
35. Arkansas	209,673,752
36. Rhode Island	208,593,490
37. District of Columbia	148,521,221
38. New Mexico	139,381,132
39. New Hampshire	127,465,174
40. Maine	125,830,479
41. Utah	120,050,075
42. Montana	106,145,881
43. Idaho	103,481,848
44. North Dakota	99,832,074
45. South Dakota	97,109,233
46. Hawaii	84,102,518
47. Delaware	76,930,905
48. Vermont	64,123,424
49. Nevada	51,878,561
50. Wyoming	48,573,869
51. Alaska	31,340,799
Totals	$33,809,348,942

SOURCE: The Insurance Industry Committee of Ohio
*Estimated
†Excludes Fraternal Benefit Societies

TABLE 4

Total Revenue Produced by Premium Taxes and Fees by States, 1960

1. California	$68,944,211.00
2. New York	66,874,301.45
3. Texas	32,591,602.27
4. Ohio	32,557,879.00
5. Pennsylvania	32,290,429.19
6. Illinois	31,134,042.87
7. Michigan	22,026,766.11
8. Massachusetts	20,105,149.00
9. New Jersey	19,254,446.00
10. Connecticut	15,652,413.23
11. Florida	14,563,617.00
12. Missouri	14,262,029.00
13. North Carolina	13,424,981.58
14. Virginia	12,908,417.00

TABLE 4 (Continued)

15. Tennessee	12,390,008.58
16. Georgia	11,514,478.06
17. Oklahoma	10,591,331.92
18. Indiana	10,370,329.04
19. Wisconsin	10,228,769.00
20. Minnesota	10,153,042.03
21. Maryland	9,694,628.71
22. Louisiana	8,484,133.91
23. Washington	8,422,379.19
24. Iowa	8,165,451.00
25. Alabama	7,846,789.00
26. Kentucky	6,860,148.01
27. Kansas	6,667,358.91
28. West Virginia	6,577,167.76
29. South Carolina	6,232,351.97
30. Colorado	6,141,877.02
31. Mississippi	5,910,855.78
32. Oregon	5,726,052.00
33. Arkansas	4,136,340.21
34. Arizona	4,079,292.49
35. Nebraska	3,916,525.67
36. District of Columbia	3,136,310.68
37. Rhode Island	2,833,731.05
38. Idaho	2,688,251.13
39. New Mexico	2,611,922.52
40. Utah	2,589,747.57
41. Maine	2,559,966.37
42. Montana	2,349,323.00
43. Hawaii	2,287,478.00
44. New Hampshire	2,184,127.44
45. South Dakota	2,129,455.09
46. Delaware	1,777,303.08
47. North Dakota	1,732,434.67
48. Vermont	1,226,868.59
49. Wyoming	1,106,134.21
50. Alaska	1,034,034.00
51. Nevada	1,008,902.00

SOURCE: The Insurance Industry Committee of Ohio

TABLE 5

Ratio of State Taxes and Fees Collected to Premium Volume Written in the States

States	Premium Volume	Premium Taxes and Fees	Percentage of Premium Volume Received in Taxes and Fees
Alaska	$ 31,340,799	$ 7,846,789	3.30
Oklahoma	361,324,983	10,591,332	2.93
West Virginia	225,313,659	6,577,168	2.92
Connecticut	560,296,221	15,652,413	2.80
Hawaii	84,102,518	2,287,478	2.72
Mississippi	220,186,402	5,910,856	2.68
Idaho	103,481,848	2,688,251	2.60
Virginia	529,142,996	12,908,417	2.44
Georgia	484,044,014	11,514,478	2.38
Delaware	76,930,905	1,777,303	2.31
Tennessee	539,764,129	12,390,009	2.30
Wyoming	48,573,869	1,106,134	2.28
North Carolina	595,625,896	13,424,982	2.25
Montana	106,145,881	2,349,323	2.21
South Dakota	97,109,233	2,129,455	2.19
Colorado	283,151,285	6,141,877	2.17
Utah	120,050,075	2,589,748	2.16
District of Columbia	148,521,221	3,136,311	2.11
California	3,318,244,497	68,944,211	2.08
Maine	125,830,479	2,559,966	2.03
Texas	1,603,583,800	32,591,602	2.03
Arkansas	209,673,752	4,136,340	1.97
Nevada	51,878,561	1,008,902	1.94
Vermont	64,123,424	1,226,869	1.91
Missouri	761,597,371	14,262,029	1.87
New Mexico	139,381,132	2,611,923	1.87
Alabama	422,083,289	7,846,789	1.86
Massachusetts	1,087,748,570	20,105,149	1.85
Kentucky	375,422,164	6,860,148	1.83
Maryland	528,566,305	9,694,629	1.83
South Carolina	341,395,367	6,232,352	1.83
Minnesota	558,475,650	10,153,042	1.82
Ohio	1,848,513,562	32,557,879	1.76
North Dakota	99,832,074	1,732,435	1.74
Kansas	385,344,843	6,667,359	1.73
Louisiana	491,120,395	8,484,134	1.73

TABLE 5 (Continued)

States	Premium Volume	Premium Taxes and Fees	Percentage of Premium Volume Received in Taxes and Fees
Arizona	237,418,998	4,079,292	1.72
Florida	884,396,356	14,563,617	1.72
New Hampshire	127,465,174	2,184,127	1.71
Washington	507,450,633	8,422,379	1.66
Oregon	346,321,352	5,726,052	1.65
Iowa	507,599,843	8,165,451	1.61
Nebraska	254,584,109	3,916,526	1.54
Michigan	1,470,909,331	22,026,766	1.50
Illinois	2,121,481,217	31,134,043	1.47
Pennsylvania	2,207,617,415	32,290,429	1.46
Wisconsin	732,458,391	10,228,769	1.40
New Jersey	1,408,404,376	19,254,446	1.37
Rhode Island	208,593,490	2,833,731	1.36
New York	4,951,727,088	66,874,301	1.35
Indiana	815,000,000*	10,370,329	1.27
Total	$33,809,348,942	$593,955,584	1.76

SOURCE: Compiled from data in Tables 4 and 5.
*Estimated

The Premium Tax

Treatment of Domestic Insurers. Illinois is one of ten states[14] that exempt all domestic insurers from the premium tax. Five of these states,[15] however, levy an income tax on domestic insurers, leaving Illinois as one of only five states imposing neither a premium tax nor an income tax on domestic insurers. The preferential treatment given domestic insurers has encouraged tax avoidance in Illinois by the placing of business in a domestic insurer only to have it reinsured 100% in a foreign or alien insurer. An important question for review is whether preferential treatment for domestic insurers in Illinois is in the public interest and, if so, whether this preferential treatment is best achieved by imposing no premium tax on domestic companies. Of particular interest here is that about 30 percent (1961) of the premiums written in Illinois were in domestic insurers, an untapped source of premium tax revenue. Thirteen states give preferential premium tax treatment to domestic companies but still levy a premium tax on these companies. For example, Alabama levies a premium tax of ½ percent on all domestic companies as compared with 3 percent on life and casualty premiums, 2½ percent on fire and marine premiums, and 1 percent on annuity premiums written on Alabama risks by foreign and alien insurers. Maine and

[14] Arkansas, Florida, Kansas, Indiana, Illinois, Michigan, North Dakota, Ohio, Oklahoma, and Oregon.
[15] Arkansas, Indiana, North Dakota, Oklahoma, and Oregon.

Washington impose a 2 percent premium tax on foreign and alien insurers and a 1 percent tax on domestic insurers. About one-half of the states charge the same premium tax on all insurance, regardless of domicile.

The Tax Rate. Illinois is among the 31 states that impose the same tax rate upon all taxable premiums, and among the 15 states that tax foreign and alien insurers at the rate of 2 percent. It is not among the ten states that allow a reduction in the premium tax rate if a certain percentage of the insurer's assets are invested in the state. One might wish to raise the question why Illinois gives preferential treatment to domestic insurers but not to insurers that invest heavily in the state. Is there an inconsistency here?

The Tax Base. Illinois is among the 38 states that allow dividends paid on life insurance policies to be deducted from the premium tax base, and among the 45 states that deduct from the tax base dividends paid on fire and casualty insurance policies. Illinois is not among the 15 states that exclude ocean marine insurance premiums from the tax base, nor among the 24 states that exclude annuity considerations from the tax base. Illinois, however, is among the 26 states that allow a deduction for termination allowances on group annuity contracts but not among the three states excluding premiums on qualified pension plans from the tax base. Attention to the question of special treatment for premiums to fund qualified pension plans would seem in order as a means of eliminating a source of discrimination in favor of trusteed pension plans.

Premium Tax Offsets. Illinois allows a credit against the premium tax for the amount of the fire department tax paid. It is among the 15 states that allow a credit against the premium tax for one or more of the other taxes and fees paid.

"In Lieu of" Provisions. In common with the majority of states, the Illinois premium tax is in lieu of some other taxes, but the Illinois "in lieu of" provision is not among the broader ones. In Illinois the premium tax is in lieu of license fees or privilege or occupation taxes of municipalities, counties, or other political subdivisions.

Evaluation of the Premium Tax. The U. S. Supreme Court held in 1869 that insurance was not "commerce" within the meaning of the commerce clause of the United States Constitution.[16] This holding left the regulation of insurance entirely up to the states.[17] The states, therefore, "enacted rather elaborate statutes regulating insurance, established state departments for the administration of these laws, and, partly in the guise of defraying such expenses of regulation, imposed substantial taxes on premiums."[18] Only a small fraction of these taxes are spent for the regulation

[16] *Paul* v. *Virginia*, 8 Wall. 168; 19 L. Ed. 357.

[17] The U.S. Supreme Court in 1944 overruled the *Paul* v. *Virginia* decision (*United States* v. *South-Eastern Underwriters Association, et al.*, 322 U.S. 533, 88 L. Ed. 1440.) Congress then enacted Public Law 15 of 1945 providing that the regulation and taxation of insurance by the states is in the public interest.

[18] Bruce E. Shepherd "Taxation of Life Insurance in the United States" *Transactions of the Thirteenth International Congress of Actuaries Scheveningen* 1951, Amsterdam: The North-Holland Publishing Company, 1951, p. 63.

of insurance. In 1960, the national average was 3.94 percent. Illinois spent only 3.5 percent of its premium tax receipts for the operation of the state insurance department.

If one holds to the theory that taxes should be levied on the ability to pay and that they be levied directly, the premium tax is unacceptable. If this theory is cast aside and the premium tax is considered with two thoughts in mind—the amount of revenue it will raise and the ease with which it can be collected without objection from voters—then the premium tax is the ideal method of taxing insurance companies.

One writer explains that the premium tax "has developed primarily because the taxation of the insurance business in any other way presents a number of special problems."[19] He goes on to explain why a property tax would not yield much revenue and why an income tax would be difficult to apply to insurance companies. Another writer elaborates the latter point as follows:

> ". . . annual systems of accounting, upon which one must depend for the determination of net income, often give a distorted picture of true net income. . . . Insurance rates cannot contemplate that all losses will occur with annual regularity. Abnormal or catastrophic losses do occur . . . The gains from operations in good years are almost certain to be needed in whole or in part to take care of the irregular but not completely unanticipated losses of other years. Hence, what appears to be a net gain under an annual system of accounting is, to some extent at least, an illusion. The averaging principle of carry-backs and carry-overs does not completely solve the problem, partly because the period is too short to coincide with the cycles in the insurance field."[20]

One advantage of the premium tax to the state is that the premium tax is likely to produce a steadily increasing revenue rather than a fluctuating revenue as would be produced by an income tax. Insurers prefer a premium tax to an income tax because the tax can be loaded into the premium rate along with other expenses of doing business.

Special Fire Insurance Taxes

Illinois is among the 17 states that impose a fire marshal tax upon all insurers writing fire insurance lines, and among the 16 states in which the tax rate is the same for both domestic and foreign insurers. It is among the 11 states charging the most common rate, ½ percent of fire premiums. The Fire Marshal Tax yielded $669,786 in 1961. Illinois is also among the 12 states that levy a specific fire department or firemen's pension or relief tax, but among the four states restricting this tax to foreign and alien companies. It is also among the three states in which credit for the fire department tax is given as an offset against the premium tax,[21] and among the eight states charging the most common rate, 2 percent of fire insurance premiums.

[19] Glenn W. Fisher "An Economist's Appraisal of the Illinois Tax System" *University of Illinois Law Forum* Vol. 1961, Winter Number, p. 569.

[20] George D. Haskell "The Taxation of Property Insurance Companies," *The Journal of Insurance*, Vol. XXVI No. 1, Spring, 1959, p. 34.

[21] Credit is given in a fourth state but for foreign and alien insurers only.

Illinois is one of seven states having both a fire marshal tax and a fire department tax.

The justification for taxes on fire insurance premiums to support the office of the State Fire Marshal and the various local fire departments is found in the loss prevention and loss protection services of these agencies which are considered to be of vital importance to fire insurance underwriters. Why the benefits accruing to the general public and to the non-insurers and self-insurers from these services should be discounted when distributing their cost is a question worthy of investigation. Would a tax on life and health insurance premiums to support the public health department, a tax on automobile insurance premiums to support the traffic safety program, and a tax on crime insurance premiums to support the police department also be justified?

Special Workmen's Compensation Insurance Taxes

Illinois is one of the 39 states including the District of Columbia that levy a second-injury fund assessment on workmen's compensation insurers. It is among the seven states that require contributions on the basis of compensable death cases and among the three states requiring a contribution based on loss of body members. Illinois is also among the 20 states that provide for suspension of contributions to the fund under certain conditions.

Illinois is not among the 18 states that have special assessments on workmen's compensation insurance premiums or special taxes to offset the costs of administration of workmen's compensation laws or to finance security funds.

Retaliatory Taxes

Illinois is among the 42 states with retaliatory insurance tax laws and among the 39 states in which enforcement of these laws is mandatory. It is also among the 39 states in which the law is imposed on an aggregate basis. The purpose of retaliatory tax laws is to protect domestic companies from heavy taxation in other states. The effect is to keep the tax rates imposed on foreign and alien insurers by the various states in line, especially in those states which have a politically powerful domestic insurance industry.

In 1959, the Illinois legislature considered raising the premium tax rate on foreign and alien insurers from the present 2 percent to 4 percent as a means of raising revenue for the state. Domestic insurers opposed the bill strongly because they would be subject to retaliatory taxes in most other states if the Illinois rate were raised. Lobbyists against the tax increase compiled figures which "showed that, for every additional dollar taken in by the State of Illinois, the companies that were domiciled in Illinois and operated in other states would pay out an additional $10 to other states."[22] An additional 2 percent premium tax on foreign and alien insurers in Illinois would add a greater aggregate burden on domestic insurance com-

[22] Robert S. Felton, "Retaliatory Insurance Company Taxation," *The Journal of Insurance*, Vol. XXVIII No. 3, September 1961, p. 78.

panies than would an extension of the present 2 percent premium tax to include domestic insurers. For example, in 1961 the Illinois writings of domestic insurers amounted to only 22.4 percent of their total premium volume. But because domestic insurers wrote only about 30 percent of all Illinois premiums in 1961, a 2 percent tax on domestic insurers would have yielded less revenue than an additional 2 percent tax on foreign and alien insurers. It would have taken a premium tax rate in 1961 of 4 2/3 percent on domestic insurers to bring in as much revenue as an additional 2 percent premium tax on foreign and alien insurers. However, because of widespread retaliatory tax legislation, a 4 2/3 percent tax on domestic insurers would have been less of a burden to these insurers (in the aggregate) than an additional 2 percent premium tax on forein and alien insurers.

When Mississippi increased the tax rate from 2¼ percent to 3 percent on the life and health insurance premiums written by foreign and alien insurers (making the rate the same as for foreign and alien fire and casualty insurers) the legislature afforded domestic insurers some protection from the adverse effects of retaliation by other states. The legislation provided "that a domestic insurance company against which is levied additional premium tax under retaliatory laws of other states in which it does business, as a result of the tax increase provided by this Act, may deduct the total of such additional retaliatory tax from the state income tax due by it to the State of Mississippi."[23] Note that the credit was given against the state income tax and not against the premium tax. Domestic companies in Mississippi are required to pay a premium tax equal to one-half of that required of foreign and alien insurers.

Taxes Not Imposed

Illinois is not among the 12 states that impose an income tax on insurance companies nor among the 15 states that tax ocean marine insurance underwriting profits. Furthermore, it is not one of the three states levying assessments on insurers to offset the cost of operating the state insurance department nor one of the two states assessing companies to pay the cost of administering rating laws.

SUMMARY AND RECOMMENDATIONS

The insurance industry is required to pay a number of different taxes and fees which vary widely among the states. As for individual levies, Illinois is with the majority of states in the following:

1. The same tax rate is applied to all taxable premiums.
2. No credit is given against the tax for investing a minimum percentage of assets in the state.
3. Dividends paid to policyholders are deductible from the premium tax base.

[23] Sections 9537.04 and 9537.05, Code 1942, amended.

4. Termination allowances under group annuity contracts are deductible from the tax base.
5. No assessments are levied on insurers to offset the cost of administering the state insurance department. (Some hold the opinion that the insurance regulatory service could be vastly improved to the benefit of both insureds and insurers if the department had adequate funds to carry out its functions effectively).
6. Contributions to a second-injury fund is the only special assessment made on workmen's compensation insurers. (Premium taxes, of course, apply to workmen's compensation premiums).
7. No income tax is imposed on insurance companies.
8. No special underwriting profits tax is imposed on ocean marine business.
9. Retaliatory taxes are imposed on an aggregate basis and the imposition is mandatory.

Illinois is in the minority on the following points:

1. Domestic insurers are exempt from the premium tax.
2. Annuity considerations are not given preferential treatment.
3. A fire marshal tax is assessed.
4. A fire department tax is assessed. Because this assessment can be credited to the premium tax, it does not represent an additional burden to the insurers although it does reduce the revenue available to the state for general purposes.

Being with the majority of states on one aspect of the tax laws does not indicate "being right" any more than being with the minority on others indicates "being wrong." In fact, "being right" or "being wrong" are not judgments which are in themselves capable of independent appraisal in the absence of generally acceptable standards of right and wrong. Therefore, it is recommended that a set of standards be developed for measuring the virtues of a good tax system for insurance companies. These standards should take into consideration not only what "ought to be" but also what "can be" in the light of the nature of the insurance business. Allowances, therefore, will have to be made for the special problems inherent in the business of insurance. These standards can be developed only by the cooperative efforts of those trained in tax theory and those trained in insurance theory.

Certain questions, however, about the Illinois tax structure as it relates to insurance companies should be reviewed.

1. Should the premium tax be treated as a sales tax rather than loaded into the premium?
2. Should premiums on "investment type" life insurance policies be taxed as heavily as premiums for a pure insurance service as in term life insurance and as in the fire and casualty lines?

3. Should premiums on group annuities be taxed while contributions to uninsured pension plans escape such taxation?
4. Should domestic insurance companies be exempt from the premium tax? (Officials of the Department of Insurance "estimate that perhaps an excess of $25,000,000 would have been received from domestic companies had we applied the two percent premium tax that we applied to the foreign and alien insurers.")
5. Should those who purchase fire insurance have to contribute more to the support of the office of the Fire Marshal and to support of the fire departments than those who purchase no insurance or those who self insure?
6. Should an effort be made through the National Association of Insurance Commissioners to achieve a greater degree of standardization in the applicability of insurance taxes with a view toward reducing the cost of computing the tax and the uncertainty of what is expected?

The present study, of course, does not provide answers to the above questions. Identifying the problems, however, is the first step toward developing an improved tax structure.

CHAPTER XXIII

TAXATION OF PUBLIC UTILITIES

By Dale H. Weeks*

The study of public utility taxation is complicated by the fact that utility companies are taxed under the general laws of taxation as well as under special laws dealing only with public utility companies. In addition, there is a great variety of treatment from state to state. For example, in some states gross receipts taxation has replaced the general property taxes on utilities at all levels of government; in others (Illinois for example), the state no longer imposes the general property tax, but local governments depend upon it for a major portion of their revenue. In this case the utility company is treated in the same manner as other property owners for purposes of assessment and payment of taxes.

The State of Illinois levies a 3% gross receipts tax on persons engaged in the business of selling electricity, gas, and messages transmitted by electricity (telephone and telegraph). This tax would presumably continue even if the state were to resume the use of the general property tax for state purposes. Illinois municipalities have been authorized to levy a tax up to 5% of gross receipts of the utilities listed above, with the addition of water companies. These taxes may be in addition to all other taxes levied by the municipality. The state utility tax might be described as a substitute for the Retailers' Occupation and Use taxes, which do not apply to the sales of utility services. In other states, state and/or municipal taxes may be levied on the basis of the number of poles, on mileage or on some other unit of measurement. In addition, a wide range of businesses is included in the term "public utilities."

The confused state of utility company taxation in Illinois is further illustrated by the fact that some municipalities levy both franchise taxes and gross receipts taxes on utility companies; some utilities are subject to the state-assessed capital stock tax, others are not; and the assessment of property—especially personalty—appears to be inconsistent from district to district within the state (in spite of the efforts at equalization by the State Revenue Department).

As will be demonstrated later in this paper, public utilities provide a significant portion of the revenue of state governments and of some municipalities through special forms of taxation. Although the main purpose of this paper is to describe these special taxes which apply to utility companies, some attention must be given to property taxation.

In general, the term "public utility" as used in this study refers only to gas, electric, telephone, telegraph, and water companies, since these are

*The author is Associate Professor of Economics, Northern Illinois University.

the types of utilities currently subject to either the state or municipal taxes in Illinois. Transportation companies (local or inter-city), steam heat companies, and other businesses that are considered public utilities, or that are taxed in the same manner as public utilities, are not considered, except where it is impossible to isolate data for these other businesses.

Theories of Public Utility Taxation

Both the benefits received theory and the ability to pay theory of taxation are used to explain the taxation of public utilities. The benefit theory assumes that utility companies benefit, as do other "persons," from the existence of government, and so should share in its cost. A major problem is to determine what tax or combination of taxes results in the payment of a fair share of the total by various taxpayers. There is a strong tendency to accept the notion that property ownership provides a reasonable measure of benefits. Since other papers in this series deal with the problems of property taxation, it will suffice here to mention that there is some question as to the fairness of assessment of utility properties as compared with other property. The assessment of personal property generally comes in for more criticism than the assessment of real estate, and the major part of the property of utility companies is classified as personal property. Tax officials, utility company executives, and students of taxation alike believe that utility property as a whole is assessed at higher rates in relation to "value" than other property. An extreme example is that of a utility company which considers that its property in one locality is assessed at 163% of "optimum fair market value" while the estimated average for all property in that locality (after application of the State multiplier) is 56%.[1] An executive of another utility company states ". . . it is our opinion that in some locations our property is assessed higher and other locations possibly lower than other business property." He goes on to add that it is not possible to determine the degree of over- or under-assessment.[1]

In any case, these comments raise doubts about the adequacy of property taxation as a measure of benefits received from government. To only a minor degree is special taxation based upon benefits received, although franchise taxes (as a payment for the use of streets) and special fees paid to the regulatory commission in connection with investigations of a utility company are generally considered to be related to the benefits that a company receives from government.

The ability to pay theory of taxation is also suggested as a basis for both general and special taxation of utilities. This theory fails to recognize that a business firm, whether a public utility or other type of business, cannot pay taxes out of the mere ownership of property; that taxes can be paid only out of the income from the property, if it is to be maintained intact for the continued operation of the enterprise. To the extent that tax costs are included as an element in rate determination cases by the regulatory

[1] Letters to the author from utility company executives.

agencies, it could be said that the taxpaying ability is present. Income is generally considered a better measure of ability to pay than property, but for business firms we find that "Most fiscal writers hold that the 'ability' concept can be applied properly only to individuals, that a business enterprise or corporation has no independent, impersonal 'taxpaying ability.' "[2] Aside from this objection there is the problem of determining the type of tax that most nearly conforms to the criterion of ability to pay. There does seem to be general agreement that a net income base with some adjustments is the most satisfactory.

A third theory that appears to be applied, particularly to the special taxation of public utilities, might be referred to as the "convenience" theory. Public utility enterprises are easily identifiable and are frequently owned by persons outside the community. In addition, there are relatively few companies, reducing the administrative problems of collection.[3] These factors make the utility industry a ready-made target for special forms of taxation.

Another theory that is applicable to the special taxation of the utility industry could be called the "regulatory" theory. Historically, utility companies and railroads have been among the so-called "regulated industries." Since these industries are singled out for regulation of the prices they may charge and the way in which they render service, there is an easy transition to the conclusion that special taxation is justifiable. Generally, the reasoning has been that the regulatory process is not working properly, with the result that the industry is making "excessive" profits. Special taxation becomes a method by which the excess profits can be drained off. This attitude does not appear explicitly in many discussions of utility taxation, but "in spite of the constant improvements in the regulatory mechanism since 1873, this basic philosophy still predominates."[4] It seems relevant to a study of taxation to suggest that taxes should normally be used for the purpose of providing revenues for government, not for the purpose of regulating economic activity, especially when the machinery for necessary regulation already exists.

Property Taxation of Utility Companies

The general property tax on public utilities in Illinois is of substantial importance to various local governmental units. An examination of utility company reports to the Illinois Commerce Commission gives some indication of the size of the property tax payments by various companies. For example, in the case of one operating utility company, the real estate, personal property and capital stock taxes combined amounted (in 1960) to approximately 2.3% of the total revenues of the company. Total taxes paid by this com-

[2] William J. Schultz and C. Lowell Harriss, *American Public Finance*, Fifth edition. New York, 1949, p. 254.

[3] The Seventeenth Annual Report of the Illinois Department of Revenue, p. 14, states, "The average number of taxpayers for fiscal 1960 was 1,072." By contrast, the Department processed some 140,000 sales tax returns each month.

[4] C. Woody Thompson and Wendell Smith, *Public Utility Economics*. New York, 1941, p. 554.

pany, including federal income taxes, amounted to 18.5% of revenues. The property taxes amounted to 12.1% of the total taxes paid by the company. The sample of companies included in Table A-1 in the appendix of this paper paid an average of 4.7% of their revenues in the form of local property taxes and the state-assessed capital stock tax. Unfortunately these data do not show the importance of the tax payments to the local taxing bodies themselves, although for the city of Chicago an approximation of the portion of property taxes collected from gas companies could be made, since Peoples Gas Light and Coke Company serves most of the city and most of its property is within the city.

The major problem in connection with property taxation of utilities is in the area of assessment. The fact that the utility company has properties in many localities and that these properties are not independent of each other, but are a part of a larger system, creates a major difficulty for local assessors, since they must assess the portions within their jurisdiction as though they were independent. As with other property, assessment by each township acting independently results in many inconsistencies from township to township and county to county, even though the State of Illinois has attempted to reduce the variations in assessments as between counties.[5] It would appear that some form of central assessment of utility property (as is now the case with railroad properties) would be desirable.

The Capital Stock Tax

Another chapter in this report discusses the Illinois Capital Stock Tax. The only comment necessary in this study is to point out that utility companies are legally subject to this tax in the same manner and to the same degree as other corporations, and the comments and recommendations in that study should apply to public utility corporations.

Special Taxation of Public Utilities

"The methods used to determine the taxes paid by public utilities, in addition to ad valorem property taxes which they pay, vary considerably. Some are based on a certain tax per pole or conduit length; others are a flat rate amount; others are based on production such as kilowatts, therms, miles traveled; and still others on gross receipts."[6]

At least 38 states levy some type of gross receipts tax on public utility companies. This figure includes railroads and local transportation systems, and other miscellaneous forms of business activity, broadly defined as public utilities, in addition to the four types of utility service covered in this study. Table 1 shows public utility tax receipts for 34 states. As indicated in the notes to that table, an attempt was made to include information only on electric, gas, telephone, telegraph and water utilities. In some cases, however, it was impossible to identify the tax receipts by type of utility, and to

[5] The study by H. K. Allen has dealt more completely with this matter.

[6] *Municipal Nonproperty Taxes*, Municipal Finance Officers Association, Chicago, 1956, p. 29.

that extent this table overstates the revenues from the utilities considered in this study.

Rhode Island obtained just over 5 million dollars from the gross receipts tax on utilities in 1960, or about 5.9% of her total tax revenues. In 1961 she obtained 5.35% of her tax revenues from utility gross receipts taxes. Illinois obtained over $44.5 million in 1960 and over $46.5 million in 1961 (5.34% and 5.33% of total state tax revenues, respectively) from the utility taxes on electricity, gas and messages. As indicated in Table 1, the average for all states using utility gross receipts taxes of the type considered in this study was nearly 2½% of total state revenues in 1960 and 1961. When the Illinois utility tax is compared with the total state treasury receipts, we find that it has produced just under 4% of the total in most recent years.

When the Retailers' Occupation Tax was adopted, the Department of Revenue attempted to include companies selling water, gas and electricity among those subject to the tax. The State Supreme Court, in *Peoples Gas Light and Coke Company* v. *Ames,*[7] ruled that the sale of "tangible personal property" was not involved, so the Retailers' Occupation Tax did not apply. As a result, the legislature, in 1935, adopted the public utilities tax on gas, electricity and messages at a rate of 3%, to match the then current sales tax rate of 3%. Since that time the sales tax rate has been reduced to 2% and then raised again to the present 3½% rate. Since it was the intent of the legislature to levy a tax comparable to the sales tax, it would appear reasonable that the state utilities taxes be adjusted to conform to the rate in the Retailers' Occupation Tax. At the present time, increasing the utility tax to 3½% would produce over $7½ million annually in additional revenues. At the level of final consumption this would place an equal tax burden upon coal, oil, and gas as sources of fuel for home and industrial uses.

There is one problem, however, in this recommendation that should be given attention. Under the interpretations of the state sales and use taxes, the electric utility that purchases coal or oil as fuel must pay the use tax. This raises the issue of the final sale of the goods; there seems to be some similarity here to the problem of taxing the sales of building materials to a contractor. However, there are two distinguishing factors: (1) there is an alternative fuel (gas) subject only to the utility tax; and (2) the purchaser, particularly the large purchaser, of utility service could avoid the utility tax by building his own generating plant. Empirical evidence of the significance of either of these effects is not currently available.

It should be pointed out that the laws establishing the Retailers' Occupation Tax and the State utilities taxes provide for a different method of administration of the taxes. In the case of the sales tax the amount of the tax is added to the price paid by the customer and stated separately in the transaction. The utility tax affects the rate for utility service only if the Commerce Commission permits the company to increase rates to cover

[7] 359 Illinois 152 (1935)

TABLE 1

State Gross Receipts Taxes on Public Utilities

(Dollar Amounts in Thousands)

	Total Tax Revenues		Gross Receipts Tax Revenues			
			1961		1960	
	1961	1960	Amount	% of Total Tax Revenues	Amount	% of Total Tax Revenues
Alabama	$ 279,475	$ 273,718	$ 2,799	1.00%	$ 2,735	0.99%
Arizona	175.323	164,965	318	a	277	a
Connecticut	251,236	238,124	7,465	2.97	7,181	3.02
Delaware	76,972	70,776	32	a	33	a
Florida	528,456	521,682	8,541	1.62	7,637	1.46
Hawaii	132,199	124,230	4,125	3.12	4,026	3.24
Idaho	69,844	68,999	1,126	1.61	1,227	1.78
Illinois	874.310	836,372	46,586	5.33	44,652	5.34
Kentucky	301,344	228,507	815	a	6,224	2.72
Louisiana	462,811	452,695	7,009	1.51	7,115	1.57
Maine	90,073	86,929	2,782	3.09	2,631	3.03
Maryland	359 044	343,579	10,269	2.86	9,874	2.87
Minnesota	382,976	352,583	8,781	2.29	8,165	2.32
Mississippi	195,881	194,300	200	a	200	a
Montana	68,697	64,868	775	1.13	675	1.04
New Hampshire	43,204	41,757	620	1.44	—	—
New Jersey	385,666	365,232	42	a	37	a
New Mexico	124,249	123,206	196	a	312	a
New York	2,086,817	1,961,008	63,046	3.02	60,092	3.06

TABLE 1 (Continued)

	Total Tax Revenues		Gross Receipts Tax Revenues			
			1961		1960	
	1961	1960	Amount	% of Total Tax Revenues	Amount	% of Total Tax Revenues
North Carolina . . .	479,439	459,373	20,309	4.24	18,507	4.03
North Dakota	62,318	60,760	—	—	1	a
Ohio	870,985	872,723	39,736	4.56	36,888	4.23
Oklahoma	285,150	275,379	436	a	404	a
Oregon	200,030	208,283	215	a	184	a
Pennsylvania	1 208,535	1 032,861	14,136	1.17	16,693	1.62
Rhode Island	95,305	86,095	5,096	5.35	5,023	5.83
South Carolina . . .	239,092	235,478	4,487	1.88	4,298	1.83
Tennessee	311,352	304,590	1,889	0.61	1,511	0.50
Texas	806,867	792,800	20,138	2.50	18,430	2.32
Utah	102,071	100,405	1,177	1.15	1,212	1.21
Vermont	45,929	43,522	68	a	65	a
Virginia	344,256	291,664	12,783	3.71	11,901	4.08
Washington	477,361	460,770	13,500	2.83	12,400	2.69
Wisconsin	441,231	426 234	11,577	2.60	11,084	2.60
Totals:						
34 States	12,858,498	12,164,467	311,074	2.42	301,694	2.48
All States	19,057,452	18 035,927	311,074	1.63	301,694	1.67

SOURCES: "Total Tax Revenue." *Compendium of State Government Finances,* Table 5. U. S. Department of Commerce, Bureau of the Census, Washington, 1960 and 1961.
"Gross Receipts Taxes." Calculated from *Detail of State Tax Collections in 1961.* Table 2, Item A2e. U. S. Department of Commerce, Bureau of the Census, Washington, 1961.

NOTES: a—Less than ½ of 1%

the amount of the tax. In practice the commissions and the courts generally agree that this is a proper charge to be included in the calculation of utility company rates. However, this charge does not appear as a separate item in the bill received by the purchaser of utility services.

In addition to the 3% gross receipts tax which goes to the General Fund of the State of Illinois, utility companies are subject to assessment by the Illinois Commerce Commission for costs in connection with investigations and hearings before the Commission. In recent years these fees have amounted to about $100,000 annually (as compared with over $40 million annually from the utility gross receipts tax). News stories during the summer of 1962 reported that the Chairman of the Illinois Commerce Commission was proposing that the use of the specific assessment be discontinued and that a small levy (earmarked for Commission operations) based on gross receipts be made upon the companies to cover the costs of investigations. At the current level of utility company revenues, a tax of only 1/10 of 1% would yield about $1½ million annually. Although in Illinois (and most other states) regulated industries are assessed for at least some of the costs of regulation, it seems appropriate to eliminate the present method of assessment. However, rather than substitute some other forms of assessment against the companies to replace the lost revenues, this writer would propose that commission costs for regulation and investigation be provided for through the regular appropriation procedures of the legislature. This recommendation is based on the proposition that the regulatory process is presumably for the benefit of all the citizens of the state, not just the utility companies or the users of the utility services.

Municipal Gross Receipts Taxes

It is difficult to obtain recent information on the use of gross receipts taxes by municipalities over the United States; the latest source with specific and fairly complete information is a 1956 report of the Municipal Finance Officers Association.[8] According to this study, in 1955 the largest non-property tax sources for municipalities (on a per capita basis) were income, sales, business gross receipts, and gasoline taxes. Public utility gross receipts taxes ranked seventh on a per capita basis. The two largest, income and sales taxes, each produced a yield of $16.25 per capita, while the public utility taxes yielded $2.31 per capita, for cities using these taxes. The property tax yield was reported as $41.25 per capita.

During the period from 1951 to 1956, 67 cities over 10,000 in population adopted the public utilities gross receipts tax, bringing the number of cities using it to a total of 341. No other non-property tax source was used by so large a number of cities at that time.[9] For the group of cities reported, the utility tax produced 5.6% as much revenue as the property tax; however,

[8] *Municipal Nonproperty Taxes, op. cit.*, p. 18 and Table 3, p. 18.

[9] No information was given in this study regarding cities of less than 10,000 population. If Illinois is typical of other states, a large number of the cities using this tax are under 10,000. In Illinois 30 of the 39 cities having the tax in mid-1962 were under 10,000.

there was great variation from city to city. For example, the utility tax was 3.26% of the property tax in cities over 1 million, and 10.69% in cities ranging from 250,000 to 500,000 in population. These figures include gross receipts taxes levied on bus and street railway companies, taxicabs, steam companies, and television antennae.[10] For all cities (over 10,000 population) using gross receipts taxes, the "per capita yields ranged from $0.02 to $12.48, while the average tax rate was 2.69% with a range in rates imposed of from 1/10 of 1% to 14%. The 14% rate was imposed by a municipality on its own municipally owned water plant, and was considered a payment in lieu of taxes."[11] The average rate of tax in 1955 was 2.67% for gas; 2.85% for electric; 2.93% for telephone; and 5.8% for water companies. It should be noted that most of the water utilities reported in this study were municipally owned.

In 1955 the Illinois Legislature enacted legislation enabling municipalities to levy a tax of up to 5% on the gross receipts of utility companies. Under the heading "Additional Taxing Powers" in the chapters dealing with municipalities[12] the statute reads that municipalities are given the power, by action of the "corporate authorities," to "tax any or all of the following occupations or privileges:" There follow four paragraphs authorizing the enactment of gross receipts taxes not to exceed 5% on "persons engaged in the business of" (1) transmitting messages; (2) distributing, supplying, furnishing or selling gas for use or consumption; (3) distributing, supplying, furnishing or selling electricity for use or consumption; (4) distributing, supplying, furnishing, or selling water for use or consumption. In all cases the tax applies only to the origination (messages) or the use (gas, electricity, water) within the corporate limits of the municipality. In the case of gas, electricity, and water the phrase "and not for resale" is included. The statute exempts transactions in interstate commerce, those that cannot be taxed under the United States Constitution or statutes, and those that are subject to or may become subject to the Municipal Retailers' Occupation Tax Act. Sales to state and local governments, non-profit institutions such as churches, and apparently, to the Federal government are not exempted under either the authorizing statute or the ordinances.

The term "person" includes any seller of the various utility services, including cooperatives, the municipality itself, and anyone who purchases utility services for the purpose of resale. A number of cities and villages in Illinois impose a utility tax on a municipally owned system. The statute also states that this tax may be in addition to any franchise tax or other payment for the use of the city streets.

Chapter 111 2/3, Section 36 of the Illinois Code provides that the utility company may make an additional charge to its customers "equal to the sum of (1) an amount equal to such municipal tax, or any part thereof,

[10] *Municipal Nonproperty Taxes, op. cit.*, p. 29.
[11] *Ibid.*
[12] Chapter 24, Section 23-113, Illinois Code.

(2) 3% of such tax, or any part thereof, as the case may be to cover costs of accounting, and (3) an amount equal to the increase in taxes and other payments to governmental bodies resulting from the amount of such additional charge." This added charge is to be stated separately on the customer's bill. Commonly, a 5% tax results in a total added charge of 5.6%.

Discussions with various persons in the utility industry and with municipal officials indicate that there were two main influences resulting in the enactment of the municipal utility tax law. The first influence was the need of cities for added revenues. It will be noted that this tax was adopted in the same year that municipalities were authorized to adopt the ½ of 1% municipal sales tax. It is probable that this was an attempt to treat utility services in the same manner as the sales of tangibles under the Municipal Retailers' Occupation Tax. (However, two important differences must be noted: (1) the rate for the utility tax could be any amount up to 5%; (2) the state collects the ½ of 1% sales tax and remits the proceeds to the city, while the city itself collects the utility tax.)

The second influence was the City of Chicago, which was also motivated by the need for additional sources of revenues. However, one element in the Chicago situation calls for special comment. When Chicago granted franchises to utility companies, a 4% fee was included in the franchise for Commonwealth Edison, and one of 3% in the Illinois Bell franchise. No fee had been provided for in the franchise of Peoples Gas Light and Coke Company. A major argument for the authorizing legislation was that it would make it possible to equalize the tax burden on Peoples Gas and Commonwealth Edison.

Chicago adopted the gross receipts tax to become effective January 1, 1956. "The Peoples Gas Light and Coke Company sued in Cook County Circuit Court to restrain enforcement of the Chicago ordinance imposing the full 5 percent tax upon persons engaged in the business of selling gas."[13] Peoples Gas took the view that the tax was invalid on two grounds: First, that the tax was not uniform as to class, since the gas company was assessed a 5% tax, while in effect the rate for Commonwealth Edison was only 1%. The State Supreme Court held that the classification by gas, electric, messages, and water provided for in the authorizing law referred to four distinct occupations or privileges, and that a city could therefore adopt differing rates for each. (Peoples Gas did not object to the lower rate on messages, nor to the lack of a tax on water; the issue was whether or not gas and electric utilities should be in the same class.) The second contention of Peoples Gas was that the tax violated the franchise issued to the company by the City. The Company contended that this tax was really a "street use" tax, and as such was in violation of the contract between the Company and the City established when the charter was granted. The Court held that the City had the express authority from the Legislature to enact this tax, and

[13] *Peoples Gas Light and Coke Company* v. *City of Chicago*, 9 Ill. 2d 348 (1956)

that since the classification was a reasonable one, "even if the actual motive of the city council was as represented (to equalize the tax burden between Peoples Gas and Commonwealth Edison), there is no constitutional bar to their so acting."[14]

The Court decision gave approval, in effect, to the rate structure Chicago had adopted. This structure provided for a 5% gross receipts tax, with a credit for the amounts paid as a franchise fee, on electric companies; a 2% messages tax; and a 5% gas utilities tax. These taxes, combined with the already existing franchise fees, resulted in a combined tax of 5% on gas and electric companies and on Illinois Bell; since there was no franchise fee in the Western Union charter, the tax on telegraph messages was 2%.

TABLE 2

Selected Tax Revenues City of Chicago (Dollar Amounts in Thousands)

1	2 Corporate Purposes Fund	3 General Property Tax	4 Municipal Sales Tax	5 Franchise Fees	6 Municipal Gross Receipts	7 Total 5 plus 6	8 Column 7 as Percent of Column 2
1948 ...	$ 79,233	$ 36,490	$	$12,260	$	$12,260	15.5%
1949 ...	77,744	36,490		9,750		9,750	12.5
1950 ...	79,128	36,490		10,612		10,612	13.4
1951 ...	84,107	40,416		11,232		11,232	13.4
1952 ...	96,650	47,021		11,751		11,751	12.2
1953 ...	98,688	48,099		12,503		12,503	12.7
1954 ...	106,496	48,578		13,352		13,352	12.5
1955 ...	115,020	48,577	8,822	14,142		14,142	12.3
1956 ...	139,557	48,844	22,145	15,091	8,532	23,632	16.9
1957 ...	144,579	49,110	22,368	15,874	10,598	26,472	18.3
1958 ...	157,922	54,876	21,328	16,286	11,152	27,438	17.4
1959 ...	167,510	67,192	23,245	17,637	12,833	30,470	18.2
1960 ...	181,479	79,985	22,627	18,197	13,661	31,858	17.5
1961 ...	206,969	102,626	22,542	18,775	14,148	32,923	15.9

SOURCE: *Annual Reports*, Comptroller of the City of Chicago, 1948-1961.

NOTES: Column 2: The Annual Reports of the Comptroller describe the "Corporate Purposes Fund" as similar to the General Fund of other cities. It does not include revenues allocated to the water, vehicle tax, motor fuel, and bond redemption funds. This fund represents some 40% to 48% of total city revenues.

Column 3: These amounts represent property tax revenues placed in the corporate purposes fund only—other funds receive property tax revenues also.

The franchise fee by itself had produced substantial revenues prior to 1956, providing approximately 12½% of the corporate fund revenues during the period from 1948 through 1955. Since 1955, with the adoption of other taxes, this ratio has fallen, until in 1961 the franchise fee produced only 9.1% of the corporate fund revenues. The franchise fee and the utility

[14] *Ibid.*, 358

tax combined produced $32,923,269 in 1961, or about 15.9% of the corporate fund revenues and 7.7% of the total city revenues. The combined franchise and municipal utility taxes currently produce about $9 per capita in Chicago, while property tax collections for all purposes are about $42 per capita. When compared with total revenues, the combined taxes have produced about 7.7% since 1957.[15] The municipal sales tax has produced a substantially constant dollar amount since 1956.

It is difficult to measure the impact of the municipal utility tax upon individual companies in Illinois. In most cases the company serves a much wider area than that of the community levying the tax. Illinois Bell Telephone Company provides one illustration of this situation. In 1961 Illinois Bell paid about 2.45% of its total revenues to the City of Chicago in franchise and municipal utility taxes; its payments to thirteen other municipalities levying the municipal gross receipts tax amounted to only 0.02% of the total revenues of the company. Commonwealth Edison, with substantial sales in the City of Chicago is in a similar position. For the companies listed in this study, the total 1961 revenues in Illinois were $1,627,985,000, and the total municipal utility taxes paid by these companies (including the Chicago franchise fee) amounted to $33,674,000, or just under 2.1% of revenues.[16] If Chicago is excluded, the utility tax is only 0.04% of the revenues of the companies studied. In the case of a company operating only in a city levying the utility tax, it is obvious that the total amount of the tax will be the same percentage of revenues as the tax rate (adjusted for revenues exempt from the tax). This is true for Peoples Gas Light and Coke Company. This company had gross revenues of $155,572,825 in 1961, and paid a tax to Chicago of $7,778,577 (4.9998% of revenues!).

Table 3 lists the Illinois cities which levy municipal gross receipts taxes on public utilities. As shown in this table, most of the cities have adopted

[15] Calculated from *Compendium of City Government Finances*, Bureau of the Census, Department of Commerce, Washington, 1957-1961.
[16] See Table A-I, Appendix.

TABLE 3

Municipal Gross Receipts Taxes on Public Utilities in Illinois

1 City	2 Applicable to	3 Date Adopted	4 Amount Collected (1962)	5 Per Capita	6 General Revenues (1961)	7 Utility Tax Rate
Brooklyn...........	a	1961	$ 4,693	$ 2.44	$ 24,748	4½%
Burr Ridge.........	c	1957	1,045	3.10	7,987	5
Cairo..............	a	1957	62,358	6.67	471,516	5
Carmi..............	a	1955	52,675	8.56	263,686	5
Carol Stream........	b	1959	8,901	10.64	17,260	5
Champaign.........	n	1962	na	na	3,372,782	2
Cherry.............	c	1961	1,583	3.15	11,083	5
Chicago............	b	1955	32,923,377	9.22	206,969,000	5§
Crossville...........	c	1956	4,139	4.74	24.677	5

TABLE 3 (Continued)

E. Carondelet	d	1956	821	1.77	2,131	3
E. Chicago Heights...	a	1958	8,135	2.49	134,549	5
E. Moline..........	b	1956	144,598	8.64	686,917	5
E. St. Louis.........	a	1960	479,444	5.87	3,713,372	5
Energy.............	b	1956	1,965	3.88	7,177	5
Freeman Spur.......	c	1958	na	na	6,919	5
Golf...............	b	1956	na	na	28,637	5
Green Rock.........	b	1956	9,351	3.49	31,576	5
Hampton...........	b	1959	3,406	4.59	17,938	5
Johnston City.......	g	1956	7,160	1.84	85,386	3½
Lake in the Hills	a	1956	11,059	5.41	49,323	5
Lansing............	b	1961	27,965	1.55	384,632	5
Lincolnshire.........	f	1960	na	na	19,537	5
Marquette Heights...	a	1956	12,565	4.99	52,679	5
Maunie............	c	1958	246	.68	5,347	2
Mount Olive........	b	1957	10,872	4.74	74,447	5
North Chicago......	n	1962	na	na	579,616	na
Rapids City.........	b	1960	2,459	3.64	13,961	5
Robbins............	b	1960	27,679	3.69	132,731	5
Rosemont...........	n	1962	na	na	92,187	3
South Beloit.........	e	1960	17,909	4.74	185,458	5
Silvis..............	n	1962	na	na	198,095	na
Southern View......	a	1960	8,420	5.67	24,430	5
Steeleville..........	n	1962	na	na	38,815	na
Urbana.............	n	1962	na	na	965,629	2
Vermont...........	h	1960	5,455	6.04	27,044	5
Warren.............	c	1962	na	na	32,960	5
Westhaven..........	n	1962	na	na	na	5
Zion...............	a	1955	69,101	5.78	409,651	5

SOURCES (other than those noted above): News stories, letters from the Illinois Municipal League, and information from utility companies.

NOTES: Column 2

a. Electricity, messages, gas, water
b. Electricity, messages, gas
c. Electricity, messages
d. Electricity, water
e. Electricity, water, gas
f. Electricity, gas
g. Electricity only
h. Electricity, messages, water

Column 3

Where taxes on various utilities were adopted at different dates, the earliest date only has been reported.

Column 4

Total reported to the Illinois Municipal League in the spring of 1962 for "the last fiscal year," which appears to have been 1962. For the City of Chicago the amount is from the Comptroller's Annual Report for the year ended December 31, 1961.

Column 5

1960 census figures used for calculating per capita revenues.

Column 6

Amounts from columns headed "Total Revenue" in Tables 1 and 2, and "Total General Revenue" in Tables 3, 4, and 5, *Statewide Summary of Municipal Finance in Illinois*, fiscal years ended in 1960. Data for Chicago from the *Annual Report of the Comptroller, 1961*, under the heading "Corporate Purposes Fund."

No percentage comparison has been made for most of these cities between the utility tax revenues and the general revenues because of the defference in the time periods for which data was available.

Column 7

Rate of tax as reported in mimeographed paper entitled *Municipal Utility Tax*, prepared by the Illinois Municipal League Information Service (undated) and mimeographed paper headed *Communities where the Municipal Utility Tax Has Been Adopted;* prepared by the Illinois Commerce Commission, dated April 24, 1961, with supplement dated March 1, 1962.

§Chicago: The rate indicated is the combined franchise fee and municipal utility tax rate for all utilities except the telegraph company, which is subject only to a 2% gross receipts tax.

na—not available

a rate of 5%, but the result on a per capita basis ranges from a low of 68 cents to a high of $10.64.[17] These differences are accounted for by the fact that some cities, Johnston City for example, levy the tax on only one utility, while others, as Lake in the Hills, levy it on all utilities; even in cases where the tax is levied on the same group of utilities, as with Carmi and East Chicago Heights, there may be wide variations in per capita receipts. The large differences seen in some cases likely come from differences in the type of economic activity in the various communities. A community with large numbers of industrial and commercial establishments will have larger per capita receipts than a purely residential community.

Although it is only recently that cities in Illinois having substantial governmental installations have adopted the utility tax, it is somewhat surprising that they are just now discovering it. Champaign and Urbana should receive substantial revenues from their 2% tax adopted earlier this year. The City of DeKalb is currently studying the probable revenues from a 5% tax on all utilities. The City Manager estimates that the total revenues for the city would be in the vicinity of $160,000 annually, while Northern Illinois University estimates its tax at $17,000 to $18,000 per year. Thus the city would obtain approximately $1.00 per capita from a source which at present pays no taxes to the City of DeKalb.

A further attractive feature, from the standpoint of the municipality, is that the tax is levied on all "persons engaged in" the providing of utility services. This means, as is true also of the state utilities tax, that REA's, cooperatives, and municipally owned plants may be made subject to this tax.

The data presented in the previous pages concerning the state 3% tax on utilities and the municipal gross receipts tax indicate that this type of tax is a consistent revenue producer for the taxing body. Both the City of Chicago and the State of Illinois have found that this tax has, over the past ten or more years, produced a continually larger dollar amount of revenue; in both cases this has been a fairly constant percentage of the total revenues of the State and of Chicago respectively. Even the various recession periods included in this analysis have had only a minor effect upon the collections under these taxes. In contrast, the municipal sales tax has produced approximately the same number of dollars for the City of Chicago each year since 1956.

From an administrative view these taxes give little problem, either to the city or to the state. Usually there are at most five taxpayers, so far as cities are concerned.[18] These taxpayers are required to make regular reports to the Illinois Commerce Commission, so that information is available to the city and to the state. Perhaps the most serious problem is that of the resale of

[17] This high figure is for Carol Stream. Carol Stream has grown substantially beyond the population figure of 836 reported in the 1960 census; a 1962 special census gives a population of about 2500.

[18] The Seventeenth Annual Report of the Illinois Department of Revenue, p. 14, states, "The average number of taxpayers for fiscal 1960 was 1,072." By contrast, the Department processed some 140,000 sales tax returns each month.

utility services. Since the ordinances (and the state utility tax laws) provide that the tax does not apply to the sale for purposes of resale, but only to the "person" selling utility services for "use and consumption," owners of buildings who purchase services from the utility company and then resell to their tenants are liable for the tax. Conversations with officials of utility companies, with a Chicago City official, and correspondence with the Revenue Department of the State of Illinois lead to the conclusion that the problem is not large. Peoples Gas and Northern Illinois Gas both indicated that they have no resale customers; most electric companies make no sales of this type. Commonwealth Edison is the only major company in the state involved in the sale to customers for resale. About 3% of Commonwealth's sales in the City of Chicago are made to building operators for resale. There does not appear to be any really simple test to determine whether the purchasers are actually paying the tax or not, but the persons concerned with it in Commonwealth Edison, the City of Chicago, and the State Department of Revenue all are agreed that there is little or no evasion. If either the state or the city fails to collect from resellers, the responsibility lies with the administrative and enforcement divisions. There may be some minor evasion by building owners or housing developers who generate their own electricity for sale to tenants or purchasers; it is possible that the taxing body would be slow to learn of such cases. At the present time, however, self-generation is of little importance.

As indicated above, the state tax was adopted after the State Supreme Court held that utilities were not covered under the sales tax law. All of the objections to the sales tax can be applied to the gross receipts tax on utility services. The tax is regressive in its effects, since low income persons pay a higher percentage of income in tax than do those with higher incomes. The utility tax is probably more subject to criticism than the general sales tax, since utility services are generally considered as necessities. One power company executive commented: "We would also like to add the comment that the working man with a large family bears a relatively heavier proportion of these taxes than the wealthy man with a small family and to this extent they are not equitable." Although students of taxation are generally agreed that sales taxes, either general or special, are regressive, and by themselves one of the less equitable forms of taxation, they point out that as part of a total tax system they may have certain desirable features. They are highly productive, often relatively easy to administer, they reach taxpayers that might not otherwise be reached, and they respond fairly well to changes in economic conditions.

It is presumed that taxes of this type reduce the consumption of utility services, except when the demand for them is perfectly inelastic. The evidence is not at all clear. The growth in population and the changes in our way of life have meant that consumption of most utility services has risen greatly over recent years; a tax may slow the growth somewhat. One utility

executive stated to the author "Since the consumption of any commodity is invariably linked with cost, we think that these taxes do have a depressing effect on the use of gas and electricity." He went on to suggest, however, that there were so many other factors involved that no one of them could be isolated. Another company executive indicated that the state tax created no problem since the user did not know he paid it; in the case of the municipal tax, his company served only two towns which have adopted it, and the company "had observed no adverse effects." (These statements imply that it is knowledge of taxes, and not the price of goods, which affect consumption!) The consensus of the companies questioned is that the tax may have adverse effects upon the amount of utility service used, but that specific examples of such effects cannot be observed. Iowa-Illinois Gas Company pointed out that the municipal tax in East Moline provides for a sliding scale rate for large interruptible customers. The scale was adopted since it was feared that the large users of gas would shift to other fuels, leaving the city with less revenue from the utility tax on gas.

A related problem is the effect of the state and municipal gross receipts taxes upon the location of business enterprises. Here, too, there is little empirical evidence upon which to base a judgment. As we study the organization of the economy and the decisions of businessmen, we examine all aspects of cost, including taxes. We make the assumption that, other things being equal, a business firm will locate in a town without a municipal tax as opposed to one which has adopted it. The same reasoning may be applied to the state utilities tax, so far as location within a given state is concerned. Utility company executives are fairly well agreed that this is the case, but also that there is little evidence to prove a case. One company representative also commented that he believed that the location of electric generating facilities was often influenced by the tax structures of adjacent states.

Community reaction to the municipal gross receipts tax has been mixed, but on the whole appears to have been more favorable than unfavorable. In early 1962 the Illinois Municipal League asked cities using the tax to comment on it. The reactions reported by the League varied from "well-accepted," "the usual reaction to a raise in taxes, but nothing more," to "At first some were rather bitter, but as time passed seems most residents have no bad feelings toward the small additional cost," and "about 5% of citizens are not happy with the tax, but most have not availed themselves of information about how this money is used." The report described East St. Louis' experience in adopting the utility tax. The tax was first adopted by the City Council on May 22, 1959. Opponents of the tax obtained petitions for a referendum, and the tax was defeated by a vote of about 5 to 4. On June 15, 1960 the Council enacted a new ordinance; again petitions for a referendum were circulated, but the petitions were held invalid by court action. The village of Robbins adopted the tax, repealed it, and again adopted it during the same year, without any referendum being held. There

have been a few cases where the tax was adopted for a specific purpose, with the understanding that it would be repealed when that purpose was accomplished. Lansing, for example, adopted the tax in November, 1961, and repealed it in the late spring or early summer of 1962, having raised the money needed. South Beloit, in its answer to the League questionnaire, stated that "the original tax, along with the added gas tax have a definite expiration period, figured to repay debts which have been incurred in prior years." The reply added that the setting of an expiration date had satisfied the opponents of the tax.

Several cities have adopted the tax over the past few years, but then, due to adverse community reaction, have repealed it, in some cases even before it became effective, and in others shortly after it went into effect. Examples include Marengo, Hebron, LeRoy, and Forest Park. Also, during the investigations for this study, the author has learned that at least the cities of DeKalb, Decatur, and Rock Island have been investigating the merits of the tax during recent months. A utility tax was recently proposed in Freeport.

As indicated previously, the municipal tax is relatively easy for most cities to administer, since only four or five taxpayers must be dealt with. There is, however, a "hidden" administrative cost with this tax as with the general sales tax: the cost to the companies upon whom the tax is imposed. Although the utility tax allows the addition of a collection fee, this fee is too small in smaller cities to cover the costs of determining the location of customers and the maintenance of the records necessary to be sure that all customers within the city pay the tax, and that none outside the city limits are billed for it. Most utility companies are not organized with the city limits as the service area—in many cases today the service area will be much wider than the city, and with the growth of housing developments on the fringes of cities the problem of identifying the location of customers in relation to the city limits is greatly increased. At present, with less than 40 cities and villages using the municipal tax the problem is relatively small.

Because of the increasing complexities of administration by the companies as more and more cities adopt the municipal tax, it is appropriate to consider some procedure by which both the taxing agencies and the companies will find the administration simplified. In view of the history of the adoption of the state and the municipal utility taxes, and in view of the similarity of these taxes to the state and municipal occupation or sales taxes, it is desirable that the utility taxes be handled in the same manner. The major problem with this approach would be the setting of a rate for the utility tax, since most of the cities which have adopted it levy the 5% rate. The municipal sales tax is only ½ of 1%. In Chicago, the revenues from the utility tax would be approximately $4 million at the ½ of 1% rate, as compared with $14 million with the present rates. East St. Louis would obtain about $50 thousand. As a rough approximation, it could be estimated

that, for most cities, the revenues would be reduced to one-tenth their present level, if they are now using the 5% rate, and if the rate were reduced to ½ of 1%.

SUMMARY

The pros and cons of the special taxation of public utilities are difficult to balance against each other. As pointed out above, the equity of these taxes can be questioned—they are consumer taxes based on expenditure on necessities. Since the taxes are based on gross receipts rather than on net profits, they do not take into account the real taxpaying ability of the companies, although under the state law the regulatory commission will presumably take this into account in rate cases, while under the municipal tax, the law requires the separation of the tax as an additional charge on the customer's bill. The taxes may have an adverse effect upon the location of industry, but the evidence is not clear. The evidence does show that an increasing number of cities are adopting the municipal tax, but that it is still being used largely by smaller cities.[19] The tax is a good, consistent revenue producer, and is easily administered, by either the state or the municipalities. It also has the merit, at the municipal level particularly, that it reaches sources of revenue that are not otherwise reached.

RECOMMENDATIONS

After consideration of the pros and cons, and recognizing the history of both the state and municipal utility taxes, as well as the sales tax, it is suggested that the Commission consider the following proposals:

1. Adopt central assessment of all utility properties.
2. Repeal the present statutes permitting the Illinois Commerce Commission to make charges for investigations and finance both investigations and the general operations of the Commission from regular biennial appropriations.
3. Raise the rate of the state utilities tax to the same rate as the Retailers' Occupation Tax, continuing to place all of the revenues from it in the General Fund.
4. Repeal the present authorization for cities to adopt the municipal gross receipts taxes at rates up to 5%.
5. Replace the municipal utilities taxes with legislation permitting municipalities (and perhaps counties) to add a designated percentage to the state utility tax for municipal purposes. The tax would be collected by the State and returned to the cities, as is now the case with Retailers' Occupation taxes.

---

[19] See Table A-III, Appendix.

APPENDIX

TABLE A-1

Total Revenues and Selected Taxes For a Sample of Utility Companies

(Dollar Amounts in Thousands)

	1952	1953	1954	1955	1956
Total Revenues......	$ 751,839	$ 825,002	$ 899,855	$1,051,085	$1,151,292
Taxes					
Total Property....	39,450	41,634	44,908	48,501	52,175
State Utility......	19,873	21,603	23,543	27,772	30,508
State Franchise....	690	722	645	773	774
Municipal Franchise					
Chicago........	11,828	12,660	13,496	14,283	15,263
Other..........	128	130	106	121	226
Total......	11,956	12,790	13,602	14,304	15,459
Municipal Utility					
Chicago........	—	—	—	—	10,110
Other..........	—	—	—	6	58
Total......	—	—	—	6	10,168

	1957	1958	1959	1960	1961
Total Revenues......	$1,220,285	$1,287,615	$1,436,756	$1,539,981	$1,627,985
Taxes					
Total Property....	58,377	63,897	66,984	72,220	79,704
State Utility......	32,428	34,093	38,152	40,980	43,362
State Franchise....	834	863	914	993	1,010
Municipal Franchise					
Chicago........	15,931	16,441	17,789	18,274	18,869
Other..........	230	230	240	212	213
Total......	16,161	16,671	18,029	18,486	19,082
Municipal Utility					
Chicago........	10,676	11,138	12,548	13,507	14,126
Other..........	81	90	119	161	190
Total......	10,757	11,228	12,667	13,668	14,316

SOURCE: Data supplied by a total of ten utility companies in the gas, electric, and telephone industries. These ten firms supply by far the largest part of the total utility services in the State of Illinois.

TABLE A-2

State of Illinois Public Utility Tax Collections, by Type of Utility, 1938-1961

Fiscal Year Ended June 30	Total	Gas	Electricity	Telephone	Telegraph
1938.......	$ 9,127,328	$1,719,665	$ 4,885,826	$2,480,948	$40,889
1939.......	9,202,817	1,711,671	4,957,407	2,492,775	40,964
1940.......	9,751,256	1,807,233	5,272,695	2,637,457	33,871
1941.......	10,379,784	1,886,160	5,627,925	2,821,238	44,461
1942.......	11,130,346	1,994,208	6,099,948	2,990,372	45,818
1943.......	11,364,168	2,048,039	6,192,046	3,080,983	43,100
1944.......	11,840,718	2,035,985	6,528,891	3,240,320	35,522
1945.......	12,345,272	2,100,501	6,818,506	3,388,978	37,287
1946*......	12,856,816	2,163,149	6,928,750	3,764,917	
1947.......	13,867,449	2,329,734	7,418,925	4,118,790	
1948.......	15,929,100	2,569,806	8,287,682	5,071,612	
1949.......	17,351,501	2,832,526	8,991,987	5,526,988	
1950.......	18,886,336	3,169,033	9,500,689	6,216,614	
1951.......	21,043,333	3,613,673	10,506,343	6,923,317	
1952.......	22,566,704	4,034,548	11,176,109	7,356,047	
1953.......	25,798,249	6,112,375	11,987,639	7,698,235	
1954.......	27,218,960	5,739,003	12,826,817	8,653,140	
1955.......	30,129,035	6,656,032	14,356,731	9,116,272	
1956.......	32,260,961	6,880,626	15,556,229	9,824,106	
1957.......	34,861,001	7,487,224	16,626,896	10,746,881	
1958.......	36,562,607	8,018,029	17,169,507	11,375,071	
1959.......	39,860,069	8,856,092	18,862,964	12,141,013	
1960.......	44,620,888	10,530,877	20,436,382	13,653,629	
1961.......	46,586,000	——	——	——	

SOURCE: Reports of the Public Utilities Revenue Division, Illinois Department of Revenue.
*Beginning with the fiscal year 1946, the telephone and telegraph taxes were combined in the Messages Tax Act.

TABLE A-3

Municipal Gross Receipts Taxes in Illinois By Size of City

Under 500	500-999	1,000-2,499	2,500-4,999
Burr Ridge	Carol Stream	Brooklyn	E. Chicago Heights
E. Carondelet	Cherry	Lake in the Hills	Green Rock
Freeman Spur	Crossville	Mount Olive	Johnston City
Golf	Energy	Southern View	Marquette Heights
Maunie	Hampton	Steeleville	Silvis
Westhaven	Lincolnshire	Warren	S. Beloit
	Rapids City		
	Rosemont		
	Vermont		

5,000-9,999	10,000-24,999	25,000 and Over
Cairo	E. Moline	Champaign
Carmi	Lansing	Chicago
Robbins	North Chicago	E. St. Louis
	Zion	Urbana

By County

Cook	7	Franklin	1
Rock Island	4	Fulton	1
Lake	3	Henry	1
St. Clair	3	Jo Daviess	1
White	3	McHenry	1
Champaign	2	Macoupin	1
DuPage	2	Randolph	1
Williamson	2	Sangamon	1
Alexander	1	Tazewell	1
Bureau	1	Winnebago	1

CHAPTER XXIV

EARMARKING

By Case M. Sprenkle and William Habacivch*

Introduction

Earmarking can be defined as the setting aside of all or part of the proceeds of a tax or fee for the financing of a particular service, such proceeds being deposited in special funds called "earmarked funds." Earmarked revenues as well as any balances in the earmarked funds are unavailable for general revenue purposes.

The literature on earmarking is notable mainly for its absence. Judging from what little discussion there has been, it would seem that the main reason for this lack is the consensus of opinion that earmarking is *per se* bad. No positive jusification for earmarking is found in the literature; those in favor of it usually offer the negative opinion that earmarking is "not as bad as all that" in particular circumstances. This lack of any existing jusification of earmarking makes it hard to understand why the practice is so widespread. In fiscal 1954 the states earmarked an average of 51 percent of their total revenue. and there is every reason to believe that the current figure is higher.[1]

Earmarking: Pros and Cons

Most of the arguments against earmarking center on the inflexibility resulting from it which often leads to inefficient allocation or budgeting of governmental resources. With large amounts of funds earmarked, both the executive and legislative branches of the state government are hampered in their budget making and fiscal control functions. White comments that,

> . . . the net result (of earmarking) is to reduce flexibility in the use of available funds, to disturb the balance between different programs, and to limit the authority of governors. . . . If, as sometimes occurs, the earmarking is written into the state constitution . . . the position is completely inflexible. Earmarking reflects the power of special interests, whose programs may be quite legitimate, and a distrust of both executive and legislative branches.[2]

A study by the Tax Foundation lists several consequences of earmarking on the budgeting process.

> 1. When legislatures earmark, they substitute an indefinite sum for a calculated amount of revenue distributed on the basis of need.
>
> 2. Because earmarked sources are distributed without regard to

*The authors are, respectively, Assistant Professor of Economics and Assistant in Economics at the University of Illinois.

[1] The Tax Foundation, Inc., *Earmarked State Taxes* (Project Note No. 38, November, 1955).

[2] Leonard D. White, *Introduction to the Study of Public Administration* (4th edition, 1955), pp. 249-50.

need, windfall revenues may accrue to specified functions. At the same time, other functions may be undersupported. Even the transfer of surpluses growing out of earmarking does not permit as efficient utilization of revenue as does over-all budgetary planning.

3. Earmarking ties up certain revenues and forces the legislature to overwork remaining sources.

4. It is necessary for the legislature to conduct a periodic examination and appraisal of all activities of government and of the relation of costs to the amounts of revenue available. This cannot be done as long as large percentages of state revenues are not subject to critical legislative review because of earmarking.[3]

A General Framework

In order to explore the implications of these criticisms, consider the situation of a governmental unit which has no earmarking. It has a given tax structure and each budget period decides on the allocation of its funds among various expenditure purposes. Suppose now the tax structure is maintained but one particular source of revenue is earmarked for a particular purpose. Either the earmarked funds available for this purpose are greater than, equal to, or less than the amount which would have been budgeted for this purpose with no earmarking.

If the funds are greater than would otherwise be available there are several possibilities. In this case, the expenditures for this purpose may not increase and a surplus will be built up in the earmarked fund. Transfers may be made from this fund for general revenue purposes, but usually with a substantial delay, and with the likelihood of rather great political pressures against such transfers (or "diversions," or "robbing," or "stealing," as it would be called by those exerting the political pressure). Until the time that such transfers take place the other functions of government would be relatively undernourished. Pressures very probably might be extertED to raise taxes in order to bring the support of these other functions back to their original level. Thus the very process of earmarking is likely to lead to a higher overall level of taxation in this case.

If the earmarked funds are greater than would be provided with no earmarking, however, it is much more likely that there will be an increase in expenditure for such purposes over what would otherwise have been spent. In this case the legislature is overproviding for this purpose since it would not, in the absence of earmarking, have allocated such an increase. With the funds available there naturally is less pressure to provide justifications for such an increase in spending, and therefore less reason to provide as close a legislative control. There is every reason for the agencies responsible for such expenditures to request more appropriations than they would otherwise, and even to make a conscious effort to find new ways to spend these funds. And, of course, in the extreme the relative lack of legis-

[3] *Op. cit.*, p. 20.

lative control may lead to extravagance and waste and even to increased opportunities for graft. Also along with the increased expenditures in this case, other governmental functions would again be undernourished, and likely there would be an increase in the overall level of taxation.

If the earmarked funds are less than would otherwise be budgeted for the purpose, it is sometimes argued that this would serve as a restraint on spending. If this occurs there would still be a misallocation of funds with the result that the functions which have earmarked funds would be undernourished. And since there would now be extra funds available for general purposes, there would likely be increased spending for general governmental purposes. There is less likelihood of extravagance and waste here than in the situation mentioned above, since the increased spending would probably be spread out among many competing agencies and functions, but all the same there is a misallocation. It is more likely that instead of undernourishment of the purposes for which the earmarked funds were set up, the earmarking will not affect the level of spending on these functions. That is, extra revenue will be appropriated from general revenue funds so that the total available funds for these functions will be the same as they would be with no earmarking. Examples of this situation in Illinois would be the Common School Fund and the various state college and university funds. Earmarking does not do any harm in this case as long as the earmarked revenues remain below the amounts which would otherwise be appropriated. In fact some have argued that earmarking serves a useful purpose here in providing a floor to expenditures for particular functions. But what this argument boils down to is that if state revenues fall off sharply the earmarked funds will keep one governmental function from being so hard hit—not only *in comparison* with the other function but at the other's expense. It is doubtful that a legislature wants or should want to decide which functions should be so protected at any time in the future and under any conceivable future set of circumstances.

Only in the case where the earmarked funds are equal to what would have been otherwise appropriated for the functions is there no immediate disadvantage in earmarking. But the very essence of any economy and any government is changing conditions and the concomitant changes in needs. It is absolutely certain that even if the original earmarked funds equalled what would have been appropriated in any event, this happy circumstance will soon disappear. The earmarked revenues will increase faster than the needs or vice versa. The difference between needs and revenues will most likely increase over the years, making the problems ever more acute.

Political Causes

Some might argue that the above analysis is oversimplified to the point of leaving out one of the most important effects of earmarking. The argument runs as follows: People dislike taxes so greatly that a legislator jeopardizes his election chances by voting for new taxes or higher rates for old

taxes. On the other hand some people can always be found who are in favor of an increased level of government spending for any particular purpose that can be conceived. If a tax can be found which hits primarily those people in favor of the spending, and if those people can be sure that the extra taxes will be spent on that purpose, the legislator will not jeopardize his position. The easiest way for the legislator to reassure those people is to earmark the tax. Thus, only by earmarking will the legislator feel able to support some expenditures which he deems important or necessary. The original discussion above is irrelevant then since it assumed a constant level of taxes, and the most important implication of earmarking is that it enables the government to obtain higher taxes than would otherwise be possible.

This may be an adequate description of political reality, but certainly does not provide *justification* for earmarking — only an *explanation* for its widespread existence. The explanation, however, is not particularly pleasant since it implies a substantial amount of ignorance and cupidity on the part of the voters and cynicism on the part of the legislators.

Benefit Theory

The description has implicit within it, however, the only serious justification of earmarking. Those people in favor of the spending will probably be those who will benefit from it. If only those who benefit are taxed then it would seem proper to ensure that the tax proceeds are used for this purpose. One of the oldest and most respected principles of taxation is the benefit principle. As an example,[4] users of the highways benefit from such use; therefore, they should pay taxes according to their benefits and the proceeds of these taxes used for roads. In order to ensure their use on roads the tax proceeds should be earmarked. This principle should be used whenever there are similar situations such that the tax and the benefit are directly connected. Thus the benefit principle of taxation is a justification of earmarking.

Unfortunately, however, the use of this justification of earmarking involves some serious problems. There are many reasons other than the benefit principle for levying particular taxes, including ability to pay, sumptuary and moral reasons, ease of administration, high revenue production, etc. Just because the benefit principle applies in some cases, there is no reason to believe that the other principles are necessarily absent. As an example, just because the benefit principle may apply in the case of roads there is no reason to assume that no other principles apply. For instance, use of the roads may be a good indication of ability to pay. Or it may be considered a luxury, or a public nuisance because of congestion or fumes, either of which could justify taxation. Highway user taxes are relatively

[4] Highway user taxes will be used as examples in this section because they are the most widely earmarked taxes and the justification for their earmarking is usually thought to be strong. It must be stressed as strongly as possible that any criticism of earmarking does not necessarily imply a criticism of the level of government support to the function. The question of earmarking is independent of how much is actually spent, and the authors have neither desire nor ability to decide the latter.

easy to administer and bring in large revenues, even when other revenues fall off. All these other factors could justify highway user taxes but could not justify earmarking their proceeds, and certainly some if these factors are present in this case. Just because the benefit principle is present does not justify earmarking all the proceeds since there may also be factors present which justify taxing for general governmental purposes.

There are other problems in applying the benefit principle. Is it true that on the average private highway users get exactly five cents benefit per gallon of gas they use?[5] Much of the proceeds of the tax is used for new highway construction, and the five cents per gallon tax will mean a certain rate of growth of our highway system. If we now build our highway system faster and add to our highway user taxes, can we justify this as increased benefits now to our highway users? The rate at which we build our highways has little to do with the current benefits obtained from highways. The benefit principle in this case explains too much. It could be used to justify a ten cent gas tax as easily as a five cent one. This type of problem arises with the benefit principle whenever the funds are spent for building up social capital.

Another problem with the use of the benefit principle to justify earmarking is that it is extremely difficult in many cases to determine both who receives how much benefit and how the tax is to be arranged so that he who receives the benefit pays the tax. In fact, if a situation is found where the benefits are easy to determine and there is a simple way to tax those beneficiaries, the question may be raised as to the reason the government is supplying the good or service in the first place. One view of government is that it should not do anything which private enterprise is able to undertake as efficiently. One of the biggest stumbling blocks to the efficiency of private enterprise in some cases is precisely the inability of it to charge those who use the service in an equitable and efficient manner. Where it is possible to charge in this way the argument is against the government entering the field at all. Those who argue for earmarking on benefit principles come perilously close to arguing that the government should not perform the service at all. This point, along with the above discussion of earmarking being caused by political pressures, leads to a further criticism of the practice. Earmarking may make it more palatable to enact taxes to provide services which may be unwarranted extensions of governmental power than to enact taxes and provide services which are much more legitimate for the government to undertake.

Usually, however, we do not have situations where the benefits can be determined so neatly. The benefit principle can still be used more as a rule of thumb rather than in its strict sense. In cases of this kind we admit that it is a rough measure indeed, but this very roughness to some extent explains

[5] Let us abstract for the moment from the complications caused by commercial vehicles. Assume there is only automobile traffic.

the government's providing the service. But there is a limit to how rough it can be and still be validly used. In some cases where it is used as a justification of earmarking, it would seem to be completely irrelevant. The benefit principle cannot be used for a large part of highway user taxes. It can be argued that a private citizen's benefit from the roads can roughly be measured by how much gas he uses (as well as the size of car he drives). But what of the commercial highway users? Do they get the benefit or are the benefits shared? The benefit is not obtained by the commercial users, alone. Most of the benefit goes to the consumer and producer in the form of lower prices for articles which have been transported over the highway system. The benefits are passed on from the trucker to the wholesaler, to the retailer, and finally to the final user. Those who never have used the highways thus obtain a substantial benefit from them in the form of lower distribution costs. It is difficult then to justify by the benefit principle the earmarking of highway user taxes to the extent they are paid by commercial users.

The extent to which highway user taxes in Illinois are paid by commercial users is substantial. In 1960, out of a total of $100 million that went into the road fund, one-half or $50 million was paid by commercial users.[6] According to figures obtained from Robert W. Harbeson, 25.6 percent of gasoline and diesel oil consumed in Illinois in 1957 was by commercial users. Assuming that this percentage remained constant through 1960, commercial users paid $35 million out of a total of $142 million of motor fuel tax revenues. The total of highway user taxes in 1960 was $242 million, and $85 million or 35 percent of this amount was paid by commercial users. Thus, for over a third of all highway user taxes the benefit principle justification of earmarking does not apply.

Stability

There is another justification of earmarking which is sometimes used in special cases. We have already mentioned the use of earmarking to provide a floor to expenditures of a certain type. This argument can be extended to include the idea that earmarking may reduce fluctuations in spending even without considering the floor it provides. The existence of earmarking may lead to less uncertainty as to future funds being available for specific purposes. With more assurance as to funds available, long range planning will be facilitated. In areas where a large part of the spending is on construction long range plans may be absolutely essential, and earmarking will help make this planning possible. Not only government planning will be helped but also that of the construction industry. If they know of long range planning by the state, and if they feel confident that funds will be available, firms will be more willing to invest in the large amounts of machinery and equipment necessary for large construction projects. Ear-

[6] See Robert W. Harbeson's study for the Illinois Commission on Revenue, *Highway-User Charges*, Table X.

marking will bolster their confidence that funds will be available, and thus will have a favorable effect on the state's economy by inducing greater levels of investment. On the other hand with no earmarking there is apt to be more variation in spending and less possibility for long range planning which will lead to less of a desire for investment.

There are several difficulties with this argument. The long range planning facilitated by earmarking may come at the expense of planning for other functions. If spending in one function is stable this will mean larger percentage changes in funds available for other functions, and therefore less possibility for planning in these other areas. The disadvantage of less planning being possible in other areas may or may not outweight the advantages obtained in the area that has earmarking. The argument also rests on the assumption that the funds available for earmarking will vary less than the funds that would be available without the earmarking. If the proceeds from the earmarked tax vary substantially, then obviously the benefits of earmarking to stability and planning will be nil. Finally there is the basic assumption in the argument that period to period appropriations from general funds will vary more than the funds available through earmarking, whether the latter vary substantially or not. Whether this assumption is true or not is a question of fact which can be answered solely on the basis of actual experience.

The area where this argument is most crucial is highway expenditures. If it could be shown that states which earmark for highway purposes have less variation in spending than those without earmarking the argument would be decided in favor of earmarking. Unfortunately, it is not possible to compare states which earmark highway user taxes with those which do not, since only two states, Delaware and Rhode Island, do not earmark such taxes. We can overcome this problem, however, by studying the effects of diversions of highway funds to non-highway uses. The amount diverted can be thought of as the amount which in fact ended up by not being earmarked. Thus the stability argument implies that the larger amounts a state typically diverts, the larger will be the variation in spending on highways. An analysis of the effects of diversion is also of interest in its own right. It is often argued that diversion leads to less expenditure on roads and is one of the most important reasons for the country having an inadequate road system. Of course, in one sense this argument is obviously true since if funds are diverted they are not available for highway use. But the really interesting question is, do states which divert more have a record of lower increases in highway expenditures?

In order to study the effects of diversion on the variability of highway spending and the growth rate of such spending data were obtained for states for the period 1950 through 1960.[7] For each state we computed the average

[7] All data were obtained from: U. S. Department of Commerce, Bureau of Public Roads, *Highway Statistics*, published yearly. Data were not available for Alaska, Hawaii and Wisconsin.

percentage of highway user taxes diverted for non-highway purposes, the average yearly percentage change in highway spending, and the variation in spending around the growth path as measured by the standard deviation of the yearly percentage changes.

The 47 states studied diverted on the average 4.7 percent of their highway user tax proceeds but there were wide differences among the states. Thirty-one of the states, including Illinois, diverted less than one percent, while only eight states diverted over ten percent. Most of the large diverters are East Coast states with Rhode Island diverting the most, 37.5 percent, but Texas and Oklahoma are also included in this group. The 47 states studied had an average growth rate of highway spending of 12.1 percent. Of the eight large diverters, four have a larger than average growth rate in spending on highways, and three of the others had growth rates within one-half of one percent of the average. For the 47 states the average variation in spending as measured by the standard deviation was 14.6 percent. Of the eight large diverters, three had standard deviations below the average and one of them, Texas, had the lowest of the 47. These results suggest that the percentage of highway user taxes diverted has little to do both with the growth of highway spending and with the variation in such spending.

Although the above results are suggestive, correlation and regression analysis are much more powerful and accurate methods of testing for these relationships. A correlation coefficient indicates whether there is a relationship between variables, and a regression coefficient measures the amount of the relationship. The correlation coefficient between percent diverted and the growth rate of spending for highway purposes is +0.169 which is not statistically significant; that is, we cannot conclude that the two variables are related. The coefficient between percent diverted and the standard deviation of percentage changes in spending is +0.388 which is barely significant; thus, diversion does seem to lead to more variation in spending. The coefficient between the growth rate and variations in spending is + 0.596 which is highly significant; the higher the growth of spending, the more the variation. This last result should not be too surprising. When a state is, on the average, rapidly increasing its highway expenditures there is more chance for large swings in expenditures caused by lack of funds at certain times, bottlenecks developing, backlogs of planning to be finished, etc.

The results of the regression analysis indicate that the growth rate is much more crucial than diversion in creating variations. If S.D. = the standard deviation of the growth of spending, G = average growth rate of spending, and d = percent diverted, then the regression results are:[8]

$$\text{S.D.} = +\,.85 + \underset{(.064)}{0.164d} + \underset{(.072)}{1.070G}$$

[8] The figures in parentheses are the standard errors. If the regression coefficients, .164 and 1.070, are more than about two times the value of their respective standard errors, then the relation between the variables is significant.

This result can be interpreted as follows: both diversion and the growth rate have statistically significant effects on variation in spending. For every increase of one percent diverted, there is less than two-tenths of one percent increase in the variation, and for every increase of one percent in the growth rate there is an increase of slightly over one percent in the variation. Thus an increase of the growth rate of spending by one percent has an effect on variations between six and seven times as great as an increase in the amount diverted by one percent. Or looked at in another way, an increase of the growth rate of spending from, say, ten to fifteen percent will be apt to increase the variation in spending by the same amount as an increase in the percentage diverted from zero percent to thirty-three percent.

The results of this analysis thus show that diversion is of extremely minor importance in increasing variation; the rate at which highway spending increases is the major factor. Thus the argument that earmarking leads to more stability and facilitates long run planning is not substantiated.

Other Arguments

Earmarking is sometimes defended on the grounds that it provides an efficient accounting framework which may yield more useful information than if tax proceeds were all buried in a general revenue fund. This is certainly not a crucial factor in the evaluation of government policy, and even if it were, anyone having had the unfortunate task of trying to make sense out of Colorado's close to 300 earmarked funds would violently disagree with the argument.

When states borrow, earmarking is sometimes justified as a method of increasing the state's credit rating and thereby lowering the cost of borrowing. Where this is the case earmarking is justified since it in effect lowers the cost of government. Earmarking is not without dangers in this use, however. If either excess funds are allowed to build up, or if the debt is paid off at a faster than anticipated rate, the earmarking will have led to a misallocation of government funds since there is no reason they should not be used for general revenue purposes.

Summary of the Arguments

In conclusion the arguments for earmarking are extremely weak. The strongest of them, the benefit principle, is found to be inapplicable for those cases where it is normally used. The advantages usually claimed for the practice turn out to be insignificant, and the disadvantages are so great as to conclude that earmarking should be abolished wherever possible.

Earmarking in Illinois

Both as to the type and to the amount of earmarking, Illinois is relatively fortunate in comparison with most other states. It is difficult to argue that the present extent of earmarking in Illinois would be a major factor in leading the state into a financial crisis, but the practice is certainly extensive enough to create rather severe fiscal problems for the state.

Constitutional vs. Legislative Earmarking

Many states, including most of those which have had fiscal crises in recent years, have constitutional provisions *requiring* earmarking in many areas. For these states the criticisms of earmarking discussed above are not strong enough in some respects. These states do not have the opportunity to transfer funds to general revenue from time to time thereby ensuring an ever growing imbalance of government support. Only through constitutional revision or amendment will there be any relief from this situation. In Illinois, as well as in the majority of other states, most earmarking is subject to legislative control. The legislature can at any time remove the earmarking provisions of any act, and thus has the power to transfer funds whenever it is desirable. The above discussion of earmarking assumes that transfers are possible although unlikely because of political pressure, and is thus applicable to Illinois' situation in particular. The Illinois legislature lacks the power to remove earmarking provisions only in the case of the various bond, interest, and retirement funds, trust funds, and building funds.

In view of the above criticisms of earmarking and in possession of the necessary legal power, the state legislature should feel no legal, moral or economic qualms about abolishing the provisions for earmarking. Stronger measures than this might even be suggested. The Council of State Governments, established by the states to further the improvement of state government organization and administration, includes in its model state constitution a section barring earmarking. The section states:

> The appropriation for each department, office, or agency of the state, for which appropriation is made, shall be for a specific sum of money, and no appropriation shall allocate to any object the proceeds of any particular tax or fund or a part or percentage thereof.[9]

If Illinois were to follow this example, it would require an amendment to the state constitution to the effect that all state funds would be deposited in the general revenue fund and no appropriations would be made from any fund other than the general revenue fund. Such an amendment to the constitution would be the most effective means of eliminating earmarking. A somewhat weaker but politically more palatable possibility is a constitutional amendment barring any additional earmarking from current taxes or any new taxes which might be passed in the future. This, coupled with the step by step removal of existing earmarking provisions through legislative action might very well be the most effective way of removing the possibility of earmarking.

Level of Earmarking in Illinois

Illinois has a low level of earmarking compared with most other states. In 1954, the last year a national survey was conducted, only eight states earmarked lower percentages of their total revenue than Illinois.[10] Illinois

[9] Cited in National Tax Foundation, *op. cit.*, p. 13.
[10] National Tax Foundation, *op. cit.*, p. 13.

at that time earmarked 39.3 percent of its revenue whereas the national average was 51.3 percent, and ten states were earmarked over 70 percent.[11]

Every indication points to the conclusion that most states are earmarking more now than in 1954. Those states which have had recent comprehensive studies of their finances have shown substantial increases in their earmarking.[12]

The Illinois Legislative Council has estimated that earmarking in Illinois has increased from 36.3 percent of total revenue in 1951 to 43.9 percent in 1958.[13] These figures overstate the amount of earmarking since for some reason the Council included Federal Highway and Conservation Aid as earmarked state funds. They also include the revolving funds which seem to us to be only accounting funds and not earmarking in the normal sense of the term. Table 1 shows the extent of earmarking in Illinois in fiscal

TABLE 1
Treasury Receipts Deposited in Illinois General Revenue Fund and Earmarked
(From State Sources)

Line	Receipts	1951 (000)	1951	1961 (000)	1961
1.	General Revenue	293,247		531,463	
2.	Non-Highway Special Funds Total	30,900		125,202	
3.	Common School	—		63,369	
4.	Other*	30,900		61,833	
5.	Total Non-Highway Funds	324,147		656,665	
6.	Percent of Non-Highway Funds Earmarked (line 2) / (line 5)		9.5%		19.1%
7.	(excluding Common School Fund) (line 4) / (line 5)		—		10.4%
8.	Highway Funds†	116,620		271,418	
9.	Total State Receipts	440,767		928,083	
10.	Percent of Total Funds Earmarked (line 2 + line 8) / (line 9)		33.4%		42.7%
11.	(excluding Common School Fund) (line 4 + line 8) / (line 9)		—		38.1%

SOURCE: Illinois Department of Finance, *Annual Reports*, Table II.
*Excludes Revolving Funds and Federal Aid to Conservation.
†Excludes Federal Highway Aid.

[11] *Ibid.*, p. 13 and p. 34.
[12] See, for example, the recent studies of Colorado, Michigan, and New Mexico finances.
[13] Illinois Legislative Council, *Earmarking State Revenues*, File 3-677, 1959.

years 1951 and 1961. The total percentage of revenue earmarked increased from 33.4 percent to 42.7 percent (or 38.1 percent excluding the common school fund which expires at the end of fiscal 1963), and the percentage of non-highway funds increased from 9.5 percent to 19.1 percent (or 10.4 percent without the common school fund). It is apparent that the increase in earmarking was almost totally caused by the addition of the common school fund and a faster growth in highway funds than in general revenue. Special funds other than these two did not increase at a rate much faster than general government receipts. This is in general agreement with the conclusions reached by the Illinois Legislative Council in their study.[14] Since 1951 the legislature has established seven new funds which have added to earmarking, but none of these funds obtain very large revenues.[15]

Appendix Table 1 describes the provisions relating to each of the major earmarked funds, including the date enacted, the source of revenue for the funds and the uses to which the funds are put.

Highway User Taxes

Highway user taxes provide by far the largest part of earmarked revenues in Illinois. In 1961 they accounted for 29 percent of total state revenue and 68 percent of the total revenue earmarked. The earmarking of highway user taxes is generally thought to have strong arguments in its favor. As we have shown above, however, these arguments are inapplicable for over a third of the revenue obtained from them, and the benefit argument for the other two-thirds of the revenue is merely an argument that earmarking is not unjustified. Thus the argument can be made that this earmarking should be discontinued.

Even though there are theoretical and practical reasons for eliminating the earmarking of highway user taxes, it is usually thought that there are legal provisions requiring the earmarking of these taxes. The Hayden-Cartwright Act of 1934 which established Federal aid to highways has a section which seems often to be interpreted as requiring earmarking. Section 12 of the Act states:

> Since it is unfair and unjust to tax motor vehicle transportation unless the proceeds of such taxation are applied to the construction, improvement, or maintenance of highways, after June 30, 1935, Federal aid for highway construction shall be extended only to those states that use at least the amounts now provided by law for such purposes in each state from state motor vehicle registration fees, licenses, gasoline taxes, and other special taxes on motor vehicle owners and operators of all kinds for the construction, improvement, and maintenance of highways and administrative expenses in connection therewith, including the retire-

---

[14] *Ibid.*, p. 3.

[15] The Motor Vehicle and Drivers' Education Funds were also enacted during this period but they represent no increase in earmarking since they obtain funds transferred from already earmarked funds.

> ment of bonds for the payment of which such revenues have been pledged, and for no other purposes. . . .

One can certainly disagree with the opening clause of this section, but this statement must be viewed in light of the financial plight of the states at the time the Act was passed. State and local revenues from most taxes fell off sharply during the depression, and the states were desparingly looking for additional sources of revenue. Revenue from the highway user taxes, however, remained at high levels throughout this period. Many states, therefore, began using some of these funds for general governmental purposes. The amount of funds transferred became so large that Congress was worried that the states would not be able to meet the matching funds requirements of the Federal Act funds for highways. In order to ensure that the matching funds would be available, Section 12 of the Hayden-Cartwright Act was added.

It is clear that the Act does not require the earmarking of any revenues from highway user taxes; it does require, however, that states spend on highways certain amounts which are determined by highway user tax receipts. The legal question involves the interpretation to be put on the phrase "amounts now provided by law." The amount of confusion over this phrase is so great that apparently even the Illinois Division of Highways does not know to what extent transfers can be made without penalty of loss of Federal Aid. The interpretation of Section 12 by the United States Bureau of Public Roads can be taken to be in effect the correct one since the Bureau is charged with the administration of the Act. Among the duties of the Bureau is the judging of conditions under which penalties would be assessed to the states. The Bureau of Public Roads interprets Section 12 as follows:[16]

(1) If a state diverted in 1934 a certain percentage of its highway user revenues it can divert that percentage of such revenues now without penalty.

(2) Any highway user taxes added since 1934, including increased rates of taxes which existed in 1934, can be diverted without penalty.

With this information the amount of Illinois highway user taxes which can be diverted without penalty can be estimated quite closely. The extent of diversion from highway user taxes in Illinois for 1934 is shown in Table 2. In that year Illinois diverted 17.1 percent of its highway user tax receipts; therefore, Illinois can divert 17.1 percent of its highway user tax revenues which were obtained from tax rates in existence in 1934. In addition Illinois can divert 40 percent of the motor fuel tax receipts since the rate was three cents per gallon in 1934 and is now five cents. License fees in Illinois were raised in 1952 so that an estimated 33 1/3 percent of current receipts can be diverted. The total amount of diversion necessary before the state will

[16] From information obtained in a letter from David S. Black, General Counsel, Bureau of Public Roads.

be penalized is shown in Table 3 for fiscal 1961 figures. For fiscal 1961 the state could have diverted as much as $120,645,000, or 47 percent, from highway user tax revenues, and would still not lose any Federal aid. The extent to which the Hayden-Cartwright Act restricts the diversion of highway funds turns out to be very small indeed.

The purpose of this discussion of highway user tax receipts is not to support the diversion of large sums of money from expenditure on highways. The level of highway expenditures is entirely outside the scope of this report. We feel, however, that it is important to point out that the state can divert quite large sums from highways without being penalized by the loss of any Federal aid. The legislature should feel just as free to divert such funds as

TABLE 2

Illinois Highway User Tax Receipts and Diversions, 1934

Motor Fuel Tax		
Total Gross Receipts		$31,006
Motor Fuel Tax Deposited		30,976
Refunds on non-Taxable Gasoline	$1,633	
Administrative Expense	155	
Total Net Receipts		29,188
Motor License Fees		
Total Receipts		18 189
Total Highway User Taxes		47.377
Diversions		
Emergency Relief Bonds	1 801	
Chicago School Fund	947	
State Common School Fund	5,357	
Total Diversions		8.105
Percentage Diverted $\frac{8{,}105}{47{,}377} = 17.1\%$		

SOURCE: Figures obtained from Illinois Division of Highways.

it may feel free to divert other funds from their originally intended purposes. There is no reason in particular for the legislature to feel it necessary to make provisions for the repayment of diverted sums to the original funds.

Current Situation of Earmarked Funds

Appendix Table 2 presents detailed information on the balances available in most of the special funds at the end of the last two bienniums, at the end of August, 1962, and estimates of balances available at the end of the current biennium.[17] The latter two sets of figures are the most important for

[17] The estimates for the end of the current biennium are obtained from the Illinois Legislative Council, *Selected Earmarked Funds in Illinois State Finance*, File 4-394, 1962.

determining any possible action to be taken. As of August, 1962, there was a total of $183,766,000 available in the special funds, of which $130,733,000 were in the various highway user funds and $53,033,000 in all of the other funds.[18] These totals undoubtedly do not reflect the actual availability of funds for possible general revenue purposes since actual payments out of the funds substantially lag both commitments from the funds and receipts into the funds during the biennium. The amounts of these funds which are free of commitments already made will be substantially lower than these figures indicate. On the other hand the balances estimated available from the funds

TABLE 3

Amount of Allowable Diversion of Highway User Taxes in Illinois, 1961

Motor Fuel Tax Receipts		$146,302	
40% of Motor Fuel Tax Receipts Divertible			$ 58,521
Motor License Fees Receipts		102,233	
33 1/3% of Motor License Fee Receipts Divertible			34,078
Miscellaneous Receipts		8,075	
Total Highway User Tax Receipts		256,610	
Less: 40% of Motor Fuel Tax Receipts	$58,521		
33 1/3% of Motor License Fee Receipts	34,078		
Total Highway User Tax Receipts Obtained From 1934 Taxes and Tax Rates		164,011	
17.1% of Receipts from 1934 Taxes			28,046
Total Amount Divertible			$120,645
Percentage of Total Highway User Taxes Divertible		$\frac{120,645}{256,610} = 47\%$	

SOURCE: State of Illinois, Department of Finance, *Annual Report*, 1961.

at the end of the current biennium undoubtedly err in the opposite direction. The total estimated available at June, 1963, is $38,301,000, of which $25,020,000 is from the various highway user funds and $12,489,000 from all other funds. These balances are estimated on the basis that revenues will remain about the same as they have been so that a pickup in the economic climate would substantially increase the amounts available. More importantly, these estimates are made on the assumption that all amounts appropriated for the biennium will be expended by the end of the biennium; thus the assumption is that there will be no lapses. The amount of lapses which accrue to each fund have been quite variable in the past, but in general the total of non-highway fund lapses have usually been rather small. Highway

[18] For this purpose we have defined highway user funds to include the Driver Education, Motor Fuel Tax, Motor Vehicle, and Road Funds.

lapses, however, are extremely variable but usually substantial. As an indication of the order of magnitude such lapses may obtain, the lowest that the balances in the highway funds have been in the last several years has been about $70,000,000. Since the estimated balances in such funds for the end of the biennium is $25,000,000, a minimum of $50,000,000 in lapses might reasonably be expected.

On the basis of an estimate of $70,000,000 available from the highway user funds, the total amount of balances in the funds which could be diverted would appear to be about $82,500,000. This amount would appear large enough to overcome the short run difficulties of the state, but such transfers to the General Revenue Fund would obviously not solve any long run fiscal problems of the state and it would only be through transfers involving some of the highway user funds that even the short run problems could be overcome since the available balances in the other funds would not be much over $12,500,000.

Prospects for the Future

Evidence as to the effects of earmarking on the State financial position in the future can be obtained from the results of another study made (by the author) for the Revenue Commission.[19] These results provide empirical justification for the claim that earmarking results both in increasing pressure on expenditures from the General Revenue Fund and in increasing pressure toward excess spending in earmarked areas.

Table 5 and Table 6 of the projections study show the expected gaps between General Revenue Fund Revenues and Expenditures out of General Revenue and the gaps between total state non-highway revenues and expenditures for non-highway purposes. By the 1969-1971 biennium, under the assumption that the low revenue and low expenditure forecasts are correct, the gap or deficit for the General Revenue Fund will be $759 million and for total non-highway purposes $663 million. The General Revenue Fund gap is thus $96 million more than for total non-highway purposes. This indicates that there will be an additional surplus in the earmarked funds of $96 million which will directly cause an increase of this amount in the inability of the General Revenue Fund to meet expenditure needs. And this result would add to an already huge gap of the $663 million. For medium projects of both revenues and expenditures there will be a surplus of $110 million which has to be added to a gap of $817 million, and for high projections of revenues and expenditures there will be a surplus of $116 million added to the earmarked funds while the total gap will be $1155 million.

The cumulative effects of the earmarked funds are, of course, even greater. For the four bienniums from 1963 to 1971 under the assumption of low revenues and expenditures there will build up an additional $255 million of surplus funds in the earmarked funds. For the cases of both medium

[19] Case M. Sprenkle, "Forecasts of Illinois State Revenues and Expenditures," Report of the Illinois Commission on Revenue.

and high revenues and expenditures the estimated surpluses are $255 million and $292, respectively.

All of these projections were made on the basis that the State revenue structure remains as it currently is. These results indicate that the practice of earmarking with the current state revenue system will lead to even worse situations in the future than exist currently.

The Problem of Dissolving Earmarked Funds

The question of abolishing earmarked funds in order to transfer their balances to the general revenue fund can be approached from several points of view. In the first place, one may single out those funds which have the largest balances in order to maximize the total transfer to the general revenue fund. In this case the basis for such transfers obviously lies in the expediency of the situation and the imminency of the fiscal crisis (real or imagined) faced by the state. The only defense that can be made for this method is that it accomplishes, within a short period, the task of transferring large amounts of money to the general revenue fund. This may be reason enough in times of an acute fiscal crisis, but this is not the present situation in Illinois. The question of earmarking should not hinge upon the expediency of the situation, for it should be decided upon recognized principles of budgeting and the social and political goals of the voters and the legislators. The absolute size of a fund is no indication of its relative position in the voters' preferences, nor is it an indication of a fund's functional efficiency.

A second method would entail a series of value judgments about each fund, and, on the basis of one or more factors inherent in such judgments, the least "desirable" or "worthy" funds would be eliminated and their revenues and balances transferred to the general revenue fund. In other words, this method assumes that there exists some political and social consensus on how these funds should be ranked in order of their importance to the voters' general welfare. It should be emphasized that the ranking process is a political decision that cannot be avoided by appeals to expediency or to the benefit theory of taxation. The benefit theory is supposedly applicable to those areas where the state performs certain functions and collects fees or charges for these services. In such cases the benefit theory is commonly used to vindicate the common practice of earmarking charge-based receipts in order to cover the general administrative costs of supplying the services. There is, however, one important condition which must be met if the benefit theory is to be applied to these funds; and that condition is that the benefits and the costs should be equal. Since most funds are created on an *ad hoc* basis, it is extremely doubtful that this condition is approximated by the funds system of Illinois. Moreover, there does not seem to be a conscious effort made toward the equalization of the charges and costs of administering such services. The benefit theory cannot be used as an objective basis for establishing special funds based upon charges or fees.

Actually, the process of requiring all services to pay for themselves leads to a situation where, in Philip Taylor's words:

> The logical extension of dedication of gasoline taxes for highway construction, doctors' fees for the benefits of the medical profession, and hairdressers' fees for the benefit of hairdressers is the dedication of tobacco taxes for the particular benefit of smokers, and liquor taxes for the particular benefit of drinkers, and property taxes for the improvement of property. In the final stages of such dedication, relief payments must cease because the indigent cannot pay their way, the legislature, the courts, the executive, if they are to continue at all, must produce services for a ready market. The budget department can be dismissed, since "earmarking" has relieved it of any duties.[20]

Thus the benefit theory cannot relieve the legislators of the burden of making political decisions about the distribution of tax and charge-based revenues. Given the regional differences and the interest groups that the special funds appeal to, it is doubtful if a consensus on the ranking of funds could be obtained, even by a distinterested commission. However, this contention should not prevent an attempt along such lines, if there is a possibility of attaining reasonably objective criteria of a fund's usefulness and efficiency.

A third method of approaching the funds system would be to annul all special funds, except those which *must* be specifically "earmarked" in order to receive Federal matching funds,[21] or those which must be earmarked by state constitutional provisions. For example, the trust funds, the building funds, and the bond, interest, and retirement funds of Illinois are subject to such provisions. Also, all Federal grants, aid, and matching funds are restricted to narrowly defined purposes and therefore are not subject to legislative and state budget apportionment. The annulment of all the remaining special funds appears to be a very naive and unrealistic proposal, but with the current political reality of the situation, it may be the only feasible way of obtaining full control and flexibility in the budget. The wholesale abolishment of all special funds (with the exception of those noted above) might prevent cries of favoritism or "robbery" which probably would arise if the funds were dissolved on a piecemeal basis.

As we have noted above, only a part of the taxes on highway users and all of the receipts of the Game and Fish Fund need be necessarily earmarked. Excluding those subject to state earmarking provisions, all the remaining special funds, even though they represent but a fraction of the state's total revenue, serve to reduce the legislators' responsibility and control of the

[20] Philip E. Taylor, *The Economics of Public Finance* (New York: Macmillan Co., 1957), p. 29.

[21] Earmarking in this context simply means that the receipts of a tax or fee are not available to the State for allocation to general functions. There is no Federal requirement that highway user taxes be put in a special fund; the receipts may be deposited in the general revenue fund, but they cannot be spent on anything but highway purposes. Thus the process of earmarking in this case is simply an accounting device that separates funds available for general use from those available only for specified purposes.

allocating process. Budget control means that the government's total resources are allocated among the various public functions so as to maximize the returns as measured against objectives. It must be recognized then, that every fund created mitigates against the control of expenditures and reduces the alternatives and resources open to the legislature for other functions. The loss of control is a serious loss which must be matched by an equivalent gain if a fund is to justify its existence. Thus, a general policy against all earmarking not only would place the burden of proof on each fund, but it would also relieve those who wish to abolish certain funds of the burden of proving that a fund should be annulled.

Obviously, there is no one correct way or panacea which could guarantee the dissolution of all earmarking in the state. If the above arguments against earmarking hold at all, the next step may be one of formulating the concrete legal and political measures necessary to effectively deal with the problem. The tools of legislation, voter referendum, and departmental policy would probably have to be employed in order to attain a constitutional amendment, or an equivalent legislative directive on the practice of earmarking special funds.

Summary and Conclusions

We have found the practice of earmarking to be unjustified in general, and for the particular areas where the practice is usually thought to have some justification, we have found that such justifications are usually attained only through a misuse of a theory or an unawareness of the facts. For these reasons we recommend the following:

1. The abolishment of all earmarking except in cases where the practice is specifically required by the State Constitution.

2. An amendment to the State Constitution forbidding the establishment of any additional taxes or increased tax rates which would require earmarking.

3. If two is impossible, we recommend that the legislature and administration jointly be put on record as being opposed to any additional earmarking.

4. The legislature should feel free to transfer immediately any earmarked funds for which there are no commitments into the General Revenue Fund. The legislature should feel no necessity to set up provisions for the return of such transfers to the original funds. This freedom of action should extend to all earmarked funds, including any of the highway user funds, except those for which the State Constitution forbids such transfers.

APPENDIX TABLE I

Sources and Uses of Illinois Earmarked Funds

FUND AND YEAR CREATED	PRINCIPAL INCOME SOURCES	PURPOSES OF EARMARKING
Aeronautics (1945)	State certificates, permits, and licenses issued to aircraft pilots	Costs of regulating and supervising State aeronautics, and for Federal provisions on Federal aid to public airports
Agricultural Premium (1927)	Harness races, five percent pari-mutuel tax and licenses; horse racing, one percent pari-mutuel tax; State fair receipts	Operating expenses of State fair (maintenance and permanent improvements), including premiums; State aid to county fairs
Common School Fund (1835)	One-sixth of the receipts collected from the sales and use tax, while the increased rates are still in effect, that is after July 31, 1959, and prior to August 1, 1963	General school aid and payments to counties for salaries and expenses of superintendents of schools, and for payments to the Illinois State Teachers' Pension and Retirement Fund
Drivers Education Fund (1957)	Two-thirds of the three dollar driver's license fee	Reimbursement of school districts that offer driver's education courses
Fair and Exposition Fund (1957)	Horse races—one percent pari-mutuel tax	State aid to fairs and expositions in counties of over 500,000 population, and to all other county fairs
Feeds and Fertilizers Fund (1961)	Inspection fees collected by the Department of Agriculture, plus brand registration fees paid by distributors	There is apparently no directive in the law as to the purposes for which the fund may or may not be expended
Fire Prevention Fund (1909)	Tax on fire insurance companies doing business in Illinois. Tax rate is one-half percent of gross premiums	To pay the operating cost of the Illinois State Fire Marshall's Office
Game and Fish Fund (1923)	Fees collected from the sale of hunting and fishing licenses, fines, and property income of the Department of Conservation, excepting income relating to state parks, forestry and lake construction	Administrative costs of game law enforcement, game stocking activities, and maintenance of public facilities for hunting and fishing

APPENDIX TABLE I

FUND AND YEAR CREATED	PRINCIPAL INCOME SOURCES	PURPOSES OF EARMARKING
Grade Crossing Protection Fund (1955)	$50,000 per month from motor fuel tax receipts	To pay for the state's share of maintenance and improvements of projects approved by Illinois Commerce Commission
Illinois Bred Thoroughbreds (1957)	Percentage of the tax on money wagered in pari-mutuel pools on all ninth or extra races held at licensed tracks in the state. The total amount cannot exceed $500,000 per annum	To provide for purses or prizes for special races held for horses bred and foaled in Illinois. Also to pay the expenses and salaries of special investigators retained by the Racing Board
Illinois Funds for Illinois Colts (1951)	A tax of one-half percent on pari-mutuel wagering at harness races	Purses or prizes for races held for Illinois sired colts at the state fair. Also, $26,400 is transferred to the general revenue fund for the salaries and expenses of special investigators
Illinois-Michigan Canal Fund (1937)	Receipts collected from the lease and rental of the properties of the Canal	Operating, administrative, and improvement activities of the Division of Waterways
Illinois Veterans Rehabilitation Fund (1943)	Unclaimed pari-mutuel tickets at running races	Three state agencies are receiving appropriations from this fund. The Department of Mental Health, the Board of Vocational Education, and the Illinois Veteran's Commission all receive funds for services rendered to veterans
Mental Health No. 50 (1951)	Payments to the state for the care and treatment of mental health patients	Operating, administrative, construction, and improvement of the services and programs set up by the state for mental health problems
Motor Fuel Tax Fund (1929)	Tax of five cents per gallon fuel used by motor vehicle operators on state facilities	Administrative costs, state highway functions, and state aid for highways to local governments. Fund receipts are distributed as follows: 35 percent goes to the state, 12 percent to counties, 10 percent to township and road districts, and 32 percent to municipalities

APPENDIX TABLE I

FUND AND YEAR CREATED	PRINCIPAL INCOME SOURCES	PURPOSES OF EARMARKING
Motor Vehicle Fund (1953)	Fees collected by the Illinois Commerce Commission in registering trucks and issuing franchises	To pay the administrative costs of the Commerce Commission in administering the Motor Carrier Property Act. All monies over and above the administrative costs must be devoted to the repair and maintenance of highways
Narcotic Control Fund (1957)	Several Sources: Net proceeds from the sale of movable property and vehicles which have been used in transporting drugs and have been seized by the state. Also the fund receives one-half of the fines collected for violations of the Illinois Uniform Drug, Device, and Cosmetic Act	There is apparently no statutory directive as to the purposes of the fund, except the payment of the enforcement costs of the Division of Narcotic Control
Road Fund (1911)	These are several sources: Federal aid, the state's share of the motor fuel tax receipts, one-third of the driver's license fees, chauffeur's license fees, any surplus in the Motor Vehicle Fund, and reimbursements for state expenditures on county road projects	Construction, maintenance, and repair of state highways; administrative costs of policing and enactment of motor vehicle registration laws; and general highway purposes
State Boating Act Fund (1959)	All registration fees, fines and income derived under the terms of the act	Administrative and policing costs of enforcing the act; construction and improvement of pleasure boating facilities; and promotion of boating safety
State Forests and Nurseries Fund (1939)	Receipts from the sale of nursery stock and forest products	Improving and managing state forests, nursery operations; and for reimbursements for the federal government's labor in state nurseries
State Parks Fund (1953)	Principal source is the admission fees charged by the state. Also all income arising from the operation of state parks is to be deposited in the fund	Maintenance, operation, development of state parks, and the acquisition of new ones

SOURCE: Revised Statutes of Illinois.

APPENDIX TABLE II

Fiscal Data: Balances in Special State Funds*†

Fund	Balances at End of Period			Estimated‡ Balance
	1957-1959	1959-1961	August, 1962	1962-63
Aeronautics	$ 14,000	$ 18,000	$ 35,000	$ 20,000
Agricultural Premium	3,797,000	4,334,000	7,443,000	5,986,000
Common Schools		–19,990,000	27,735,000	
Drivers Education	5,842,000	3,748,000	4,402,000	1,805,000
Fair and Exposition	403,000	505,000	1,436,000	235,000
Feed and Fertilizer			176,000	NA
Fire Prevention	534,000	1,004,000	715,000	1,299,000
Game and Fish	1,531,000	794,000	1,414,000	–389,000
Grade Crossing Protection	577,000	1,063,000	1,177,000	1,000
Illinois Bred Thoroughbreds	263,000	431,000	675,000	537,000
Illinois Fund for Illinois Colts	404,000	596,000	714,000	862,000
Illinois-Michigan Canal	137,000	228,000	304,000	323,000
Illinois Veterans Rehabilitation	418,000	237,000	128,000	46,000
Mental Health No. 50	8,943,000	8,804,000	9,833,000	–2,378,000
Motor Fuel Tax	77,804,000	89,870,000	78,227,000	12,283,000
Motor Vehicle	723,000	1,139,000	1,463,000	1,013,000
Narcotic Control	23,000	40,000	55,000	57,000
Road	13,428,000	52,397,000	46,641,000	11,724,000
State Boating Act		168,000	202,000	265,000
State Forests and Nurseries	338,000	344,000	328,000	220,000
State Parks	285,000	492,000	663,000	542,000
Total			$183,766,000	$38,301,000

SOURCE: Department of Finance.

*Note that all trust funds are omitted; these are not subject to legislative appropriation.

†There are other funds which are listed in the Illinois Finance Code as special funds, but have not been included in the above list. Such funds may be divided roughly into three categories: first, charged base funds and revolving funds; second, funds which are inoperative or receiving no current revenues; and third, several bond, interest and retirement funds as well as several building funds. These funds and their balances as of the end of August, 1962, are given below, in Appendix Table 3.

‡Estimates from Illinois Legislative Council, *Selected Earmarked Funds in Illinois State Finance*, July, 1962.

APPENDIX TABLE III

Other Funds

I. Charge-Based and Revolving Funds

Fund	Balance, August 31, 1962	
Southern Illinois University Income	$ 664,000	
Teacher's College Income	1,318,000	
University Income	1,640,000	
Legislative Service	6,000	
Paper, Print and Office Supplies	230,000	
State Garage	532,000	
Welfare	80,000	
Working Capital	1,437,000	
Total		$ 5,907,000

II. Inoperative Funds, and those not Receiving Current Income

Fund	Balance, August 31, 1962	
Emergency Relief—B. I. and R.	$ 225	
Illinois Korean Compensation	2,492,000	
Road B. I. and R.	38,000	
Soldier's Compensation	177	
Soldier's Compensation—B. I. and R.	3,000	
Waterways	000	
Waterways maintenance fund	000	
Total		$ 2,533,402

III. Bond, Interest and Retirement, and Building Funds

Fund	Balance, August 31, 1962	
Public Welfare Building	$ 48,157,000	
Public Welfare—B. I. and R.	2,651,000	
Service Recognition—B. I. and R.	21,417,000	
Universities building	126,038,000	
Universities building—B. I. and R.	7,867,000	
Total Groups I, II, III		$206,130,000

CHAPTER XXV

FEES, CHARGES, AND OTHER NON-TAX SOURCES OF REVENUE

By Richard K. Vedder*

Introduction

Non-tax sources of revenue provide a relatively small, but not insignificant part of Illinois' revenue needs. Their importance seems to have increased somewhat since World War II. Non-tax revenues include license fees, inspection fees, user charges, and certain quasi-business operations, such as the operation of college dormitories. Fees generally are imposed where the state provides a service that primarily benefits certain individuals or businesses.

Unfortunately, no single principle can be applied that can always determine the optimum fee level. Usually, however, where the benefits of a service accrue solely to an individual or business concern, the fee should be high enough to cover the cost of the service provided—and no higher. Society should not pay for something which solely benefits an individual.

This principle, however, cannot be applied easily where a service benefits *both* certain individuals and society at large. Higher education is an example of such a service. From an education, individuals gain financial security, prestige, and a sense of well-being reflecting intellectual fulfillment. Society as a whole, though, also gains materially from having a well educated population. To the extent that society is benefited, general taxation should subsidize the service. Individuals who benefit should pay for the rest of the cost of the service in the form of fees. In practice, of course, it is impossible to separate precisely the social benefits from the individual benefits.

Often, paying the entire cost of the service provided is considered an inequitable burden on the person receiving the service. To avoid this, some state activities are subsidized by tax revenues, even though particular individuals are the sole or primary beneficiaries of the service. Thus, a low-income family of a mental health patient is not expected to pay the $1,500 annual cost of caring for the patient for to require such a payment would be considered an inequitable burden on the patient's family.

Another consideration in fee determination is that collection costs frequently are much higher than the administrative costs of broader-based taxes. If the cost of administering the fee is exceedingly high relative to the cost of the service provided, it might be beneficial to drop the fee entirely and finance the operation with general tax revenues.

Thus, a general principle of fee determination is applicable only if

*The author is a graduate Fellow in Economics at the University of Illinois.

certain conditions are met: if the fee is for a service that solely benefits an individual or business firm, if the fee is reasonably cheaply administered, and if the fee can be levied without causing an inequitable burden on the recipient of the service. Fortunately, many of the fees in Illinois meet these conditions, so the simply general principle that individuals who derive the benefits should pay the cost of the service is applicable.

In times of economic stringency, it might be tempting to increase fees and user charges as a means of reducing financial difficulties. This temptation should be overcome, for two reasons. First, the revenue obtainable from sizable increases in fees is likely to be very small compared with the total revenue needs. Second, such an increase in fees unfairly burdens the relatively small segment of the population that pays most fees. Increasing broader-base taxes is both more successful in raising revenue and more equitable.

As Table 1 imperfectly illustrates, these non-tax sources of revenue are highly dependable as to yield, showing steady growth throughout the entire post-war period. These revenues, furthermore, appear to be fairly invulnerable to major economic decline. The demand for services provided by the state which are involved here is generally quite inelastic, insuring good

TABLE 1

Receipts From Fees, Charges and Earnings Compared With Total Revenues From All Sources

Year*	Receipts From Fees and Charges†	Percent of Total State Revenues‡
1961	$45,591,948	4.9
1960	41,522,792	4.7
1959	42,423,689	5.4
1958	44,686,150	5.8
1957	35,564,562	5.0
1956	33,480,450	4.9
1955	29,352,316	5.2
1954	30,272,675	5.3
1953	28,635,998	5.3
1952	20,337,717	4.2
1951	18,607,335	4.3
1950	19,072,415	4.6
1949	19,980,750	4.6
1948	17,293,104	4.1

SOURCE: Reports of the Auditor of Public Accounts and of the Department of Finance.
*Statistics in this table and in other tables pertain to the fiscal year ending June 30.
†It is extremely difficult to accurately state the yield of all non-tax revenues. This table does not include all university income. At the same time, it does include some fees that really more closely resemble taxes. 1960 and 1961 are partially estimated.
‡Net revenues.

yields even in the deepest depression. Of course, there are exceptions; university fee revenue probably would suffer significantly in a period of prolonged economic decline.

Further study of Table 1 shows the futility of increasing fees and charges in order to ease temporary economic difficulties. Doubling all fees and user charges in the late 1950's would have boosted state revenues by barely three percent. This is not to say, however, that many fees and charges should not be increased. The prime consideration usually is whether the fee to charge covers the costs involved.

In order to obtain some idea of the change in the level of fees and charges in the last generation, a comparison with the level of fees 10 and 20 years ago was made, using occupational, inspection, and fish and game fees as the basis of comparison. The results of this comparison are shown in Table 2.

TABLE 2

Level of Selected Fees

Year	Level of Selected Fees (As Percent of 1942 Fees)
1942	100
1952	130
1962	213

SOURCE: *Illinois Revised Statutes for* 1941, 1951, and 1961.

It would appear that in the 1942-1952 decade fees lagged behind increasing costs resulting from inflationary pressures. Either fees generally were too high in 1942 or too low in 1952. In the last decade, however, fees and charges have been increased rapidly, probably faster than the costs of providing the various services involved. If, as it appears likely, that the level of fees and charges was generally too low in 1952, then the rapid increase in fees in recent years probably has been economically beneficial.

While Table 2 shows a steady increase in fees and charges, some individual fees have changed little, if at all. Eight of the 22 fees surveyed have not changed in the last 20 years. On the other hand, four fees have at least tripled since 1942. In the case of the unchanging fees, such as the milk pasteurization plant fee, the amount currently charged is definitely out of line with the current cost of the service provided, unless the fee was far greater than it should have been in 1942, or the nature of the service has changed considerably. One fee in the comparison, the plumber examination fee, was reduced from $100 to $25, probably not reflecting a drop in the cost of the examination, but rather a commendable decision to prevent the use of licensing as a means of restricting the entry of workers into an occupation. This former invidious practice of using examination fees to restrict the supply of workers has apparently been abandoned.

A comparison of Illinois license fees with those of other states is of limited value, as the services provided are not always comparable.

The examination for a plumber, for example, might be far more comprehensive (and costly) in Illinois than in another state. Nonetheless, for all licenses and examinations, the general level of fees should not vary enormously from state to state if all states are following the same principle of fee determination. Tables 3 and 4 provide a comparison of the license revenue burden in Illinois with other economically similar states. These tables exclude motor vehicular, alcoholic beverage, corporation filing, university

TABLE 3

State License Revenues in Selected States — 1961

State	Revenue	Revenue as Percent of Total Tax and License Revenue
New York	$33,512,000	1.61
California	31,168,000	1.39
Michigan	13,942,000	1.44
ILLINOIS	11,299,000	1.29
Wisconsin	10,556,000	2.39
Ohio	9,839,000	1.13
Missouri	7,554,000	2.22
Indiana	6,733,000	1.88

SOURCE: *State Government Finances in 1961*, Bureau of the Census, Tables 5 and 7. Table is for fiscal 1961.

and hospital patient fees. Occupational, business, public utility and fish and game fees are the most important fees included in these tables. It is easily seen that the burden of license fees generally is lighter in Illinois than in the other selected states. Of course, for some specific licenses, the fee is higher in Illinois than elsewhere. Whether the generally lower Illinois license revenue is due primarily to lower fees or to less license activity is unknown. Though Illinois fees undoubtedly run somewhat lower than in these other states, it would be incorrect to conclude from this fact alone that Illinois fees are too low. The "correct" fee level is usually determined by service costs, and not by the general fee level of other states.

Because of the large number of licenses and charges in Illinois it is impossible to review each in detail. Rather, a few of the important non-tax revenue sources will be briefly discussed. Since it is often very difficult to determine the actual cost of supplying the various services, only a more detailed study on the part of the various fee-collecting agencies can ascertain the level of fees appropriate for each service provided. Such a study would benefit from the recent adoption of performance budgeting techniques.

Fee revision should, ideally, occur any time there is a significant change in the level of state wages or other service costs.

TABLE 4

The Burden of State Licenses in Selected States — 1961

State	Per Capita Revenue	Revenue Per $1,000 Personal Income
Wisconsin	$2.62	$1.20
Missouri	1.73	.79
Michigan	1.75	.77
New York	1.97	.69
California	1.90	.68
Indiana	1.43	.65
Ohio	1 00	.43
ILLINOIS	1.08	.41

SOURCE: *State Government Finances in 1961*, Bureau of the Census, Table 7, and *Survey of Current Business*, August, 1962.

Fees and Other Charges Collected by the Department of Registration and Education

This department administers the most complex system of fees and charges. Virtually all the revenue comes through the Registration Division, which administers the licensing of 26 professions and trades. In the 1959-1960 fiscal year, the Department issued over 22,000 original certificates and 238,000 license renewals.[1]

Licensing is necessary for professional status; thus the Department has strong potential regulatory powers in the licensed professions under its jurisdiction. Licenses must be renewed, often annually, which strengthens the Department's control over professional qualifications. Thus, the public is protected from unqualified practitioners in the various professions.

The Department licenses funeral directors and embalmers, pharmacists, real estate brokers and salesmen, vocational schools and their solicitors, water well contractors, dentists, nurses, optometrists, plumbers, public accountants, physicians and surgeons, osteopaths, obstetricians, chiropractors, midwives, other medical practitioners, chiropractors, architects, barbers, physical therapists, engineers, structural engineers, beauty culturists, detective agencies and agents, land surveyors, tree experts, and horseshoers.

There seems to be no justification for a public subsidy of the Registration Division's activities, as the license fees charged in these 26 professions and trades can be passed along to their patrons. After all, these regulatory activities benefit only those who avail themselves of the service of the prac-

[1] *1959-1960 Annual Report of the Department of Registration and Education.*

titioner in question. Therefore, it is appropriate for those consumers to pay the regulatory costs.

Table 5 shows the steady increase in the Department's revenue, reflecting both more licensing activity and higher fee schedules. Since World War II, the costs of running the Registration Division have risen somewhat less than the increase in revenue. While in the 1946 fiscal year license fees were not quite high enough to cover the Department's regulatory costs, in 1961 revenues exceeded expenditures by over $200,000[2] (in the previous fiscal

TABLE 5

Receipts of the Department of Registration and Education

Year	Receipts	Year	Receipts
1946	$436,994	1954	$ 682.684
1947	611,186	1955	627,659
1948	502.265	1956	735,824
1949	508,753	1957	683,016
1950	476,474	1958	974,478
1951	459,327	1959	1,172,847
1952	585.895	1960	1,225,756
1953	673,982	1961	1,123.031

SOURCE: Reports of the Auditor of Public Accounts and the Department of Finance.

year, the surplus was $400,000). The evidence, then, shows that the over-all level of fees is somewhat too high; a very small part of the population is being unfairly taxed.

Although the over-all level of fees is slightly too high, some fees probably are in fact too low for the service provided, while others are exorbitantly high. The increase in 1959 in the renewal fee for architects from $1 annually to $20 biennially is a case in point. Before 1959, it appears architects were subsidized; since then, they have been taxed. Meanwhile, while architect's faced a ten-fold increase in renewal fees, real estate salesmen, for example, continued to pay the $1 renewal fee that they have paid for many years.

Generally, the present system of charges seems to place somewhat higher fees on those in high-income occupations. As the incidence of the fees generally falls ultimately on the consumer who benefits from the service provided, rather than on the practitioner, this "ability to pay" criterion now prevailing is less satisfactory than the "cover regulatory costs" criterion.

Uniformity seems to be a desirable objective, considering the wide variations in the current fees. It does not seem likely that the costs of the services provided by the Department vary strikingly from one profession

[2] *Ibid.*

to another, so a uniform fee schedule could be devised which would both simplify the current system and reduce inequities now existing. Of course, the inequities which exist are rather trivial considering the fact that fees are a minor expense to the generally well-to-do practitioners in these professions. The fact that these fees can be used as a Federal income tax deduction reduces the unfairness in the fee structure. Nonetheless, these minor inequities should be eliminated.

The following proposed fee schedule would reduce existing inequities, simplify the complicated fee structure now being used, and would cover the cost of operating the Registration Divisions:

Examination fees	$10.00
Certification fee	5.00
Renewal fee, per year	2.50
Reinstatement fee (regardless of time lapse)	5.00
Fee to determine preliminary education	5.00
Student or apprentice registration fee (annually)	2.50
Master's or teacher's registration fee (annually)	2.50
Journeyman or assistant registration fee (annually)	2.50
Reciprocity fee	5.00
Retake of any examination	10.00
Duplicate of lost or destroyed certificate	5.00
Registration of firms, agencies, or schools	40.00
Annual renewal of such registration	10.00

If the cost of the regulatory service provided for any occupation far exceeds the revenues obtained from the above fee schedule, adjustment should be made. But the above schedule should be adequate for the majority of occupations where regulatory costs are reasonably similar. Uniform fee schedules are not something novel; our neighboring state of Iowa, for example, has had one for years.

The practice of biennial licensing has become quite common in recent years, and probably could be extended to most of the professions which still have annual licensing. While the Department's regulatory authority might appear weakened by biennial licensing, the Department still retains license-revoking procedures which can be used in cases of fraud and incompetency.

The Department's licensing operations could be extended to other heretofore unlicensed areas where allegations of incompetency and fraud have been widespread. The automobile and television repair businesses, for example, should probably be regulated. Also, perhaps salesmen in certain fields, such as in the used car business, should undergo regulation by the Department.

Secretary of State

Table 6 shows the rapid increase in the non-tax revenues of the Secretary of State. The treatment of motor vehicle licenses and fees is found elsewhere in the general study. As the revenue from corporation filing "fees"

far exceeds the costs of the services provided, there appears to be a very large measure of taxation involved in these various fees. As this form of taxation is inequitable as among various types of companies, it would seem appropriate to reduce these "fees" to a level reflecting the cost of the service provided. Lost revenue could be obtained by new or higher broadly-based taxes on income or assets, rather than on the number of documents filed with the Secretary of State. The Securities Division of the Secretary's office would be self-supporting even after a reduction in fees of nearly 50 percent.

TABLE 6

Secretary of State — Fees Exclusive of Franchise Taxes and Motor Vehicular Fees

Year	Receipts	Year	Receipts
1946	$ 975,052	1954	$1,557,879
1947	1,281,098	1955	1,597,818
1948	1,287,503	1956	1,966,006
1949	1,283,728	1957	1,826,287
1950	1,437,778	1958	2,532,346
1951	1,332,924	1959	2,940,243
1952	1,391,798	1960	2,969,092
1953	1,476,302	1961	3,465,624

SOURCE: Reports of the Auditor of Public Accounts and the Department of Finance. Figures for 1960 and 1961 are estimates, as corporation fee and tax revenue was combined in the available data. The ratio of fees to total corporation fees and taxes for the two preceding years was used in making the estimate.

Department of Agriculture

The Department of Agriculture administers a large number of fees which provide over $1,000,000 of annual revenue to the State, about double the yield obtained immediately after World War II. Statistics of these fees are presented in Table 7.

The various inspections and regulations of the Department protect the large number of consumers of agricultural products. These are the people who should pay the costs of regulation. Therefore, fees of the Department should cover the costs of the regulatory services provided. Outmoded accounting procedures made it somewhat difficult to ascertain the costs involved in the various services provided; a thorough study should be made by the Department of these costs. Some observations, though, can be made concerning the over-all fee level.

The Division of Foods, Dairies and Standards maintains a force of 70 inspectors and spends over $700,000 annually. Yet the Division receives only about $400,000 in fee revenue.[3] Unless the Division undertakes some opera-

[3] *Department of Agriculture, Annual Report,* and *Department of Finance, Annual Report.*

tions which are not, and should not, be supported by fees, a 75 percent increase in the general fee level would seem advisable. Further study would be necessary to ascertain how the increase in charges should be proportioned among the various fees.

The Division of Grain Inspection, the other main revenue-producing section of the Department, appears to be operating on a self-sustaining basis with no large revenue surplus, so no change in grain inspection fees appears necessary.

The Division of Livestock Industry produces little fee revenue, although the Division renders specific regulatory services which should be largely

TABLE 7

Department of Agriculture

Year	Receipts	Year	Receipts
1946	$ 523,394	1954	$ 935,189
1947	880,651	1955	971,369
1948	636,557	1956	1,023,148
1949	652,125	1957	1,044,708
1950	859,524	1958	1,134,460
1951	962,265	1959	1,166,409
1952	1,606,112	1960	1,164,450
1953	1,740,150	1961	1,179,387

SOURCE: Reports of the Auditor of Public Accounts and the Department of Finance. The abnormally high revenue for 1952 and 1953 resulted from a temporary inflow of State Fair Revenue.

self-sustaining. The Division administers the laws relating to livestock disease control and eradication. In the 1960-1961 fiscal year, some $1,231,880 was spent by the Division in performing its services, while fee revenue appears to have been about *1 percent* of that amount. Although Federal aid provides the Division with some funds, cursory examination indicates that new livestock fees and increases in other fees are advisable.

Similarly, other divisions of the Department which provide inspectional services and which currently receive little or no fee revenue should be placed on a more self-sustaining basis. A majority of the expenses of such inspectional agencies as the Markets Division and the Division of Apiary Inspection are met through taxation rather than through inspection fees. It seems irrational to make grain inspection a self-sustaining operation, while subsidizing other agricultural inspection heavily from taxes. In any general revision of Illinois fees and charges, special attention should be given to the Department of Agriculture which, for the large part, administers a system of fees and charges woefully inadequate in covering the inspectional costs of the Department. New inspection fees covering regulatory costs

would be equitable and would help relieve the demand for funds obtained through taxation.

State Treasurer

The great majority of the revenue received by the State Treasurer comes from investment income and interest on state funds. This source of revenue has grown quite rapidly in the post war years, and now ranks with university fees and mental health patient fees as the leading source of non-tax income. Increases in surplus funds, along with higher interest rates, apparently account for this large increase in revenue. In addition, the Treasurer administers some rather minor fees, such as that on safety deposit boxes. Statistics of fees received by the Treasurer are shown in Table 8.

TABLE 8

State Treasurer — Fees and Interest on Public Funds

Year	Receipts	Year	Receipts
1946	$1,314,832	1954	$3,258,843
1947	1,147,634	1955	2,085,259
1948	3,188,610	1956	2,506.868
1949	2,997,205	1957	3,742,756
1950	2,313,353	1958	4,814,591
1951	2,265,632	1959	4,008,590
1952	1,981,934	1960	5,963,545
1953	2,993,537	1961	7,057,252

SOURCE: Reports of Auditor of Public Accounts and Department of Finance.

Department of Financial Institutions

Since its establishment in fiscal 1959, this department has become a significant source of non-tax revenues, reflecting the switch in the administration of banking fees from the office of the Auditor of Public Accounts. In the 1961 fiscal year, the Department received $966,033 in building and loan, credit union, and banking fees. These fees covered slightly more than 40 percent of the Department's operating expenses. The customers of these financial institutions are being protected by the Department's policing activities, and thus should pay the costs incurred. A section of the banking amendment to the Illinois State Constitution approved on November 6, 1962, provided for an improvement in the bank examination fee schedule. The increase in the level of fees was a substantial move towards eliminating the inadequacies in the old law, though the increase approved appears insufficient in totally eliminating the current deficit in banking fee revenue.

Oil Inspection Fees—Department of Revenue

Table 9 shows the steady increase in the revenue from the inspection fees for petroleum. Actually the fee of three cents per 100 gallons of gasoline

and kerosene inspected is more of a tax, as inspection fee revenue far exceeds inspection costs. In the 1960-1961 fiscal year, revenues exceeded expenditures by $643,000.[4] An inspection fee of one and one-third cents per 100 gallons would be more than adequate to cover regulatory costs. Any increase in petroleum taxes should be accompanied by a decrease in inspection fees to a level reflecting the cost of the regulatory service provided.

TABLE 9
Oil Inspection Fees

Year	Receipts	Year	Receipts
1946	$502,437	1954	$ 881,376
1947	570,167	1955	900,603
1948	629,777	1956	977,581
1949	663,795	1957	999,715
1950	714,031	1958	1,001,074
1951	769,293	1959	1,013,517
1952	775,749	1960	1,083,792
1953	835,606	1961	1,106,386

SOURCE: Reports of Auditor of Public Accounts and Department of Finance.

Department of Conservation and the Game and Fish Fund

Game and fish license revenues support 30 to 40 percent of the total activities of the Department. Since the Department does undertake operations not directly related to fish and game conservation, it would be unwise to increase these licenses in order to make the Department self-sustaining. Current fish and game license revenue slightly exceeds the combined expenditures of the Fish, Game Management, Game Propagation, and Law Enforcement Divisions of the Department.

Within the past decade, new legislation temporarily led to a modest charge for the use of Illinois state parks; this charge was dropped by the 1961 General Assembly. Concession royalties and admission fees provided nearly $300,000 in fiscal 1961. Many will contend (as apparently did the 1961 Legislature) that the state park system was created to provide free recreational facilities for citizens of Illinois, and that admission fees are in direct contradiction to the whole philosophy of public parks. Also, it is likely that the cost of administering park fees is high in relation to the revenue obtained. On the other hand, it can be argued that it is unfair to tax non-users of parks for the benefit of the minority of citizens (many of them from other states) who generally use state parks. As the State is in fact providing a non-essential luxury commodity, it is argued that the beneficiaries of this service should pay. If this argument is a valid one, park admission fees

[4] *Annual Report* of the Department of Finance.

should be re-established at a higher level than before, as the old fees provided less than 10 percent of the total needed to operate, maintain and improve state parks.

Incidentally, a number of other states have park or camping fees. Also, the United States Department of Interior is considering levying user charges in the national park system.

TABLE 10

Game and Fish Fund

Year	Receipts	Year	Receipts
1946	$1,246,074	1954	$2,425,822
1947	1,432,865	1955	2,607,348
1948	1,683,588	1956	2,762,852
1949	1,895,443	1957	3,038,725
1950	1,873,491	1958	3,422,463
1951	1,997,187	1959	4,306,074
1952	2,486,517	1960	3,748,313
1953	2,268,318	1961	4,341,809

SOURCE: Reports of Auditor of Public Accounts and Department of Finance. Includes some Federal grants, which were abnormally large in 1959 and 1961.

Department of Public Health

The growth of revenue in the department of Public Health largely reflects the beginning of the Mount Vernon and Chicago Tuberculosis sanitariums in 1952 and 1953, respectively. These two institutions are the main source of revenue for the Department, though the Department still receives income from a number of fees which it administers.

Whether patient fees are at the correct levels at the sanitariums is impossible to ascertain from published reports of the Department. The cost of patient care has been steadily climbing[5] and patient fees should therefore be adjusted periodically to keep them abreast of such increases. In the interest of fairness and uniformity, the formula for fee determination should be the same for tuberculosis sanitariums as for mental health hospitals, except the maximum rate for the sanitariums should be considerably higher, as the cost per patient-day is nearly four times higher in the sanitariums. Mental health patients fees are discussed later in the report.

In the 1960 and 1961 fiscal years, annual income from statutory fees approximated $155,000,[6] about four times the revenue obtained in 1945 and 1946. This considerable increase is largely due to new fees, particularly those

[5] Expenditures per patient day increased from $13.46 in 1956 to $15.68 in 1960, according to the information from the *Annual Report of the Department of Public Health.* Thus in 1960 a patient would have been required to pay $470 a month in fees if he were to cover the cost of his care. Obviously, few can afford to pay this fee; hence considerable governmental subsidies are essential if treatment is to be offered to all citizens.

[6] *Annual Report* of the Department of Finance.

on trailer parks. Besides trailer parks, licenses are issued for milk pasteurization plants, nursing homes and migrant labor camps. These licenses serve as a safeguard against unhealthful operations. Also, the newly established Office of Vital Statistics produces some fee revenue.

While it is difficult to ascertain whether the licenses actually cover regulatory costs, it is highly doubtful that milk pasteurization plants can be properly regulated on the approximately $3,000 revenue obtained from that fee (the $10 charge has remained unchanged for at least 20 years).

Department of Mines and Minerals

The Department administers the license to store explosives, oil and gas well drilling permits and royalties for oil and gas products extracted on public lands. The general stability of these revenues is indicated in Table 11. Since the Department primarily serves the extractive industries, these industries and their customers should defray most of the costs of the Department. Current revenues of the Department cover less than 20 percent of operating costs. Mining inspection fees would serve to place the Department on a more self-sustaining basis; there appears to be no justification for subsidizing the extractive industries.

TABLE 11

Department of Mines and Minerals

Year	Receipts	Year	Receipts
1946	$61,533	1954	$ 92,049
1947	65,280	1955	124,898
1948	75,897	1956	125,927
1949	79,757	1957	95,661
1950	87,172	1958	82,996
1951	90,787	1959	78,935
1952	73,528	1960	125,510
1953	80,622	1961	114,283

SOURCE: Reports of the Auditor of Public Accounts and the Department of Finance.

Illinois Commerce Commission

The Commission annually receives about $325,000 from warehouse fees and various public utility fees. See Table 12 for statistics of these fees. The Division of Public Utility Regulation spends about $1,200 annually in the performance of its duties. It would seem proper for the utilities under regulation to pay all the costs of the Division of Public Regulation. Of course, over $50,000,000 is raised annually from the utilities (and ultimately their customers) through the state public utility tax. Thus public utility fees are rather trivial relative to the tax. Abolishing these fees would not be unfairly subsidizing the utilities. However, if fees are to be retained, it

might be well to increase them sufficiently to cover the regulatory costs incurred. The current practice of basing license fees on the par value of stock and the principal of bonds is not a desirable one, as the "fee" is not directly related to the cost of the service provided. As examination charges should just cover the costs involved, it would be a better arrangement to allow the Commission discretionary powers in setting fees for inspections of warehouses and the issuing of securities.

TABLE 12

Illinois Commerce Commission

Year	Receipts	Year	Receipts
1946	$ 57,495	1954	$416,384
1947	160,465	1955	295,056
1948	351,927	1956	229,788
1949	346,844	1957	369,703
1950	226,919	1958	501,844
1951	197,129	1959	324,703
1952	358,508	1960	325,000
1953	217,646	1961	327,440

SOURCE: Reports of the Auditor of Public Accounts and the Department of Finance.

Mental Health Patient Fees

The 1961 General Assembly established a new Department of Mental Health, removing mental health operations from the Department of Public Welfare. The Welfare Department had received a minor amount of revenue from the license on private mental health institutions and the sale of patient-made products. The only truly significant revenue obtained, however, was from payments of patients under its care. Table 13 shows in graphic detail the rapid rise in both patient revenues and mental health expenditures, during a period when the number of patients has remained remarkably stable. Despite the steady increase in operating costs, costs per patient per day remain incredibly low, less than 30 percent of tuberculosis patient costs, for example. But revenue received from patients has covered only a very small portion of the comparatively low costs of mental health rehabilitation.

Of course, there are many reasons why more patients and/or their families cannot be expected to pay most of the cost of rehabilitation. One is that the period of confinement is typically longer than with physical illnesses. In fiscal years 1953 and 1954, for example, 42.8 percent of all first admissions of the mentally ill were not discharged within one year of being admitted.[7] Paying even $4 per day can become an unbearable financial bur-

[7] *Report of Governor's Conference on Philosophy and Program of the Illinois Patient Pay Plan,* 1961.

TABLE 13

Mental Health Patient Fees

Year	Income	Expenditures	Revenue Per Patient Day	Expenditures Per Patient Day	Number of Patients*	Revenue As a Percent of Expenditures
1961	$8,699,863	$66,935,292	$0.53	$4.10	50,614	13.0
1960	8,066,075	70,809,737	0.48	4.21	50,714	11.4
1959	7,378,901	61,988,771	0.44	3.67	51,005	11.9
1958	6,641,939	59,210,467	0.39	3.45	51,723	11.2
1957	5,298,381	50,712,109	0.31	2.94	52,251	10.4
1956	5,062,090	48,915,925	0.29	2.79	52,590	10.3
1955	4,162,865	45,376,570	0.24	2.58	52,432	9.2
1954	3,350,773	43,525,293	0.19	2.52	52,590	7.7
1953	2,383,351	43,895,749	0.14	2.56	52,160	5.4

SOURCE: Departments of Public Welfare and Mental Health.
*In mental hospitals and schools, as of January 1 of each year.

den for most patients or their families if borne over a prolonged period of time.

Even more important, the average income of patients or their families appears to be exceedingly low. In fiscal year 1961, no payment was received for 26,408 patients or their responsible relatives, who were determined by the Department of Mental Health to be financially unable to make any contribution on the basis of standards established.[8] Thus nearly 60 percent of the mental health patients in fiscal 1961 were entirely dependent on state appropriations for their mental health care.

The current schedule of patient fees determined by the Department of Mental Health took effect on July 1, 1957. The old maximum monthly payment of $60 per month was increased to $81, the amount now in effect. It is of considerable interest to note that per capita costs have risen nearly

TABLE 14
Monthly Mental Health Patient Fees

Monthy Income of the Family Unit	Number of Persons In Family Unit (all dependents except the patient) 1	2	3	4	5	6	7
$300-309	$15	$	$	$	$	$	$
350-359	30	15					
400-409	45	30	15				
450-459	60	45	30	15			
500-509	75	60	45	30	15		
550-559	81	75	60	45	30	15	
600-609	81	81	75	60	45	30	15
650-659	81	81	81	75	60	45	30
700-709	81	81	81	81	75	60	45
750-759	81	81	81	81	81	75	60
800-809	81	81	81	81	81	81	75
850-859	81	81	81	81	81	81	81

SOURCE: Department of Mental Health, *Mental Health Regulation No. 53.* Voluntary payments over the amounts in this schedule are accepted.

40 percent in the period since the last change in fees was made. While the $81 per month maximum fee was nearly adequate to cover patient costs in 1957, this is no longer true.

The current schedule of fees charged a patient's relatives depends on the income of the relative and the size of his family. No payments are expected from anyone with less than $260 per month gross income. For every $10 per month gross income over $260, the relative is expected to contribute $3 per month to the support of the patient. For each dependent over one (not counting the patient) that the supporting relative has, mental health

[8] *Ibid.*

payments are reduced $15 monthly. These fees are in addition to the costs of the patient's clothing and incidental personal needs.

In 1961 Governor Otto Kerner called a Conference on Philosophy and Program of the Illinois Patient Pay Plan. The delegates at the conference were largely representatives of various organizations concerned with mental health problems. On June 22, 1962, the group unanimously approved recommendations to adjust the current fee schedule, which would result in an estimated annual addition of $1,683,674 in revenue to the Mental Health Fund.

The most significant recommendation from the standpoint of revenue is increasing the maximum charge for patients or their estates to the average per capita cost of mental health care, which currently approximates $123 per month. Maximum payments for relatives of mental health patients, however, would be reduced to $50 per month. These changes would produce an additional $1,428,785 in revenue.

Another recommendation calls for the restoration of financial liability for mentally retarded and mental health patients between the ages of 6 through 17 inclusive. This would produce an estimated $464,428 additional annual revenue. These patients and their families are currently exempt from payments. The final recommendation directly related to patient fees calls for ending the liability of relatives after 12 years of paying fees on the basis of financial ability. This recommendation would result in a revenue loss of $209,539 annually.

It is earnestly hoped that the recommendations of the conference will be adopted by the Seventy-Third General Assembly. The increase in the maximum rate of patient fees to a level reflecting current costs is in accordance with the general principle that fees should cover costs. Easing the burden on relatives of patients is also a desirable objective. While patients cannot be expected to pay the entire cost of the service provided, forcing relatives to pay a large share of those costs is less defensible from the standpoint of equity. Indeed, some states require no payments from relatives. Similarly, the rather arbitrarily chosen 12 year cut-off period is another commendable effort to ease the burden on relatives of patients. The current exemption from payments enjoyed by families of patients in the 6 through 17 age bracket is indefensible, and should be repealed.

Adoption of the conference's recommendations would reduce inequities, increase revenues, and re-establish the principle that fees should reflect the cost of the service provided.

University Fees and Earnings

State university fee and other non-tax revenue sources have grown quite rapidly in recent years, reflecting higher fees and charges, increased enrollments and expanded quasi-business operations, such as the operation of dormitories and research contracts with private concerns. because of the rapid increase in no-tax revenue, state appropriations from the General

TABLE 15

Current Income of the University of Illinois, 1952-1962

(000 Omitted)

Year	State Appropriations	U. S. Government Grants	Student Fees*	Gifts, Grants,† Contracts	Sales Services‡	Auxiliary Enterprises§	Other¶
	(numbers in parentheses are percentages of revenue source to total current income)						
1952	$31,884 (65.6)	$1,832 (3.8)	$2,943 (6.0)	$ 5,373 (11.0)	$ 975 (2.0)	$ 4,768 (9.8)	$ 866 (1.8)
1953	32,353 (64.3)	1,830 (3.6)	2,659 (5.3)	6,705 (13.3)	1,033 (2.1)	4,783 (9.5)	947 (1.9)
1954	33,983 (63.5)	1,894 (3.5)	2,926 (5.4)	6,733 (12.6)	1,318 (2.5)	5,552 (10.4)	1,120 (2.1)
1955	34,233 (62.0)	2,179 (4.0)	3,092 (5.6)	7,079 (12.8)	1,286 (2.3)	6,087 (11.0)	1,290 (2.3)
1956	38,799 (61.6)	2,601 (4.1)	3,837 (6.1)	8,529 (13.5)	1,293 (2.1)	6,502 (10.3)	1,456 (2.5)
1957	38,702 (58.6)	2,789 (4.2)	3,915 (5.9)	10,273 (15.6)	1,363 (2.1)	7,038 (10.7)	1,890 (2.9)
1958	46,379 (60.2)	2,896 (3.8)	4,203 (5.5)	11,596 (15.0)	1,625 (2.1)	7,665 (9.9)	2,759 (3.5)
1959	46,382 (57.8)	3,129 (3.9)	4,205 (5.2)	12,593 (15.7)	1,786 (2.2)	9,089 (11.3)	3,115 (3.5)
1960	56,025 (59.3)	3,152 (3.3)	4,103 (4.4)	15,011 (15.9)	1,864 (2.0)	10,421 (11.0)	3,864 (4.1)
1961	55,908 (56.2)	3,279 (3.3)	4,391 (4.4)	18,035 (18.1)	1,943 (2.0)	11,518 (11.6)	4,295 (4.4)
1962	61,449 (54.8)	3,706 (3.3)	4,935 (4.4)	21,585 (19.2)	1,970 (1.8)	13,578 (12.1)	4,892 (4.4)

SOURCE: *Comptroller's Report*, University of Illinois, for each year, 1952-1962.

*Including receivables from U. S. Government.
†Including U. S. Government contract.
‡Of educational departments only.
§Gross income of dormitories, bookstores, etc.
¶Includes organized activities relating to educational departments; gifts and endowments for scholarships, fellowships and other student aid; and other income.

Revenue Fund generally are a somewhat smaller share of the total current income of the state universities than was the case a decade ago.

The rapid growth of such auxiliary enterprises as residence halls, union buildings, family housing, bookstores, and hospital and medical services has had an essentially neutral effect on the finances of the state. Capital outlays in these areas generally require no state appropriations, as the projects are financed by issuing revenue bonds. The income from these operations covers all the costs of providing the auxiliary services, including debt retirement. As these operations seem to have followed the principle that services benefiting specific individuals should be paid for entirely by these individuals where possible, no further discussion of these enterprises is necessary. The same applies to sales and services of various educational departments, such as the sale of agricultural commodities by the University of Illinois College of Agriculture.

TABLE 16

Current Income of Southern Illinois University, 1952-1961

(000 Omitted)

Year	State Appropriations	Students Fees	Gifts, Grants	Auxiliary Enterprises	Student Aid
	(numbers in parentheses are percentages of revenue source to total current income)				
1952	$ 3,540(82.5)	$ 259(6.0)	$ 34(0.8)	$ 415(9.7)	$ 3(0.1)
1953	3,340(81.1)	218(5.3)	51(1.2)	466(11.3)	7(0.2)
1954	4,009(79.2)	200(4.0)	64(1.3)	739(14.5)	38(0.8)
1955	4,169(76.6)	226(4.2)	122(2.2)	867(15.9)	48(0.9)
1956	7,493(81.8)	333(3.6)	201(2.2)	1,031(11.3)	82(0.9)
1957	6,784(74.7)	425(4.7)	371(4.1)	1,397(15.4)	69(0.8)
1958	10,664(73.7)	950(6.6)	679(4.7)	2,002(13.8)	123(0.8)
1959	11,164(70.2)	1,080(6.8)	1,099(6.9)	2,402(15.1)	130(0.8)
1960	14,809(71.9)	1,348(6.5)	1,393(6.8)	2,885(14.0)	123(0.6)
1961	15,409(66.5)	1,910(8.2)	2,167(9.4)	3,518(15.2)	135(0.6)

SOURCE: *Reports of the Business Manager* and, for 1961, *Financial Reports of Southern Illinois University.* Auxiliary enterprises include student activities. Sales and services are excluded, but accounted for less than one percent total current income in every year.

Similarly, much of the enormous expansion in research activities has been undertaken without burdening the state treasury. A rapid increase in Federal and private research grants and contracts has occurred in recent years, supporting many of the additional projects in this area. It is very difficult to ascertain whether private research contracts cover all the costs involved. If any such contracts do not cover all costs they should be carefully reviewed to determine whether adjustments are desirable. Federal research grants are supposed to cover the costs of undertaking the research, although some university administrators have stated that these grants do not

cover all the indirect expenses involved. Nonetheless, it appears that the increase in Federal and privately supported research has occurred without imposing a significant burden on the state treasury.

One "auxiliary enterprise" of the University of Illinois, however, the Education and Research Hospitals in Chicago, is a significant financial burden on the State of Illinois. The President of that university recently stated that these hospitals operate with an annual deficit of $7,000,000 annually.[9] He has suggested that a sizable increase in patient fees would

TABLE 17

Tuition and General Required Fees, At the Six State Universities in Illinois 1962-1963 Academic Year

University	Tuition or Registration Fee		Other Fees Required of all Students
	Resident	Non-Resident	
Illinois	$170.00	$520.00	$100.00
Southern Illinois	126.00	276.00	58.50
Illinois State Normal	120.00	290.00	75.00
Northern Illinois	120.00	290.00	111.00
Eastern Illinois	120.00	290.00	90.00
Western Illinois	120.00	291.00	75.00

SOURCE: Provided by officials of the various institutions.

help eliminate this deficit. He added that some other state universities with similar hospitals operate such hospitals on a self-sustaining basis. It is hoped that patient fees will be increased. However, in the interest of equity and uniformity, the payments expected from lower-income families should not be appreciably different than payments made for the same length of confinement at other state hospitals. The maximum rate, charged persons with high incomes or assets, should equal the cost of the service provided (except in cases where a new and dangerous experimental treatment is being administered, where the patient's participation is of considerable benefit to society).

One comparatively minor but rapidly growing source of revenue is gifts, scholarships, fellowships, and other student aid. The increase in student assistance has undoubtedly helped make it possible for many students to attend college, who might not have been able to afford higher education otherwise.

The one non-tax source of revenue which deserves closer consideration is tuition and other fees charged by the six state universities. The increase

[9] Dr. David Henry, in response to a questionnaire prepared for the Economy Subcommittee of the Illinois Commission on Revenue.

in fee revenue at the University of Illinois and Southern Illinois University is shown in Tables 16 and 17. At Illinois, tuition and fees account for a smaller share of current income in 1961 than in 1951. This does *not* mean, however, that students are now paying a smaller share of their instructional costs than students paid in 1951, because University operations not directly related to instruction have increased more rapidly than instructional activities. At Southern Illinois University, clearly the students are paying a larger share of the operating costs (including instructional costs) than a decade ago. At the four universities under the jurisdiction of the State Teachers College Board, no substantial change has occurred in the share of instructional costs met by student fees. At these universities, as well as at the two

TABLE 18

Increase in Resident Required Fees Since 1941 at State-Supported Institutions of Higher Education in Illinois (1941 Equals 100)

University	1941	1951	1962
Illinois	100	133	300
Southern Illinois	100	149	351
Eastern Illinois	100	154	359
Illinois State Normal	100	154	300
Western Illinois	100	250	650
Northern Illinois	100	250	513

SOURCE: Bulletins and catalogues of the various institutions.

larger state universities, student fees generally have doubled in the past decade.

Unfortunately, it is a hazardous task to ascertain the exact proportion of instructional costs being covered by student fees. Faculty members, for example, divide their time in varying proportions between teaching, research, and public service. Therefore, it is difficult to determine what proportion of salaries for the entire University of Illinois faculty actually went towards providing instruction. Any estimate of the proportion of instructional costs met by student tuition fees is little more than an "educated guess". Similarly, it is extremely difficult to compare accurately the burden borne by students at the six universities. From the fact that student fees account for more of the total budget at Southern Illinois University than at the University of Illinois it does not necessarily follow that students at Southern pay a larger share of *instructional* costs than students at Illinois, as non-instructional activities are probably more extensive at the latter institution.

While the complexity of a modern large university limits observations

and comparisons of student fees among state-supported institutions of higher education in Illinois, certain data can be safely presented. Table 17 shows the current schedule of tuition and other generally required fees at the six state universities. Table 18 clearly points out the considerable increase in these fees over the past two decades. Nonetheless, it can be safely said that tuition and other related fees cover only a small fraction of the total instructional costs. The importance of state appropriations in meeting instructional costs is suggested by Table 19. Without exception, tuition at schools without state subsidies is substantially higher than at any of the state universities.

TABLE 19

Tuition Fees for Selected Illinois Private Colleges and Universities for the Regular Academic Year 1961-1962

Institution	Tuition
Augustana College	$ 750
Loyola University	800
Millikin University	800
Northwestern University	1,200
Rockford College	1,000
University of Chicago	1,050

SOURCE: Bulletins of the various institutions.

How do Illinois fees compare with those of universities in other states? Here again, caution must be exercised in making such a comparison, since the quality of education varies among institutions. Two schools might have the same tuition fee, but one school might provide its students with a high-quality education and much individual attention, while the other institution might provide poor educational training, with large classes and little individual attention. Also, some schools give generous amounts of scholarship aid and tuition waivers, while other schools grant much less financial assistance to their students. By way of illustration, the University of Illinois granted an estimated $1,838,171 in exemptions from fees in 1961-1962, more than one-third the amount actually collected in fees. Over 60 percent of the exemptions, incidentally, went to graduate students and staff members.[10]

With this warning, Table 20 shows required fees at selected leading state universities for the 1962-1963 academic year. It is to be noted that the fees of the University of Illinois are somewhat below the average for the group. Among the 13 institutions listed in Table 20, the University of Illinois ranked tenth from the highest for both resident and non-resident fees, though its fees were not substantially below the median level. This, however, for rea-

[10] *Report of the Comptroller*, 1961-1962.

sons given above, does not necessarily mean that University of Illinois students pay a smaller share of their instructional costs than do students at other schools. It will be noted that the rank for Southern Illinois University was twelfth for resident students and thirteenth for out-of-state students.

TABLE 20

Tuition and Other Required Fees, Thirteen Major State Universities, 1962-1963 Academic Year

	In-State	Rank	Out-of-State	Rank
Cornell	$325	4	$ 725	6
Ohio Sate	330	3	780	5
Penn. State	525	1	1,050	1
Rutgers	490	2	590	12
Southern Illinois	184	12	334	13
California	173	13	723	7
Colorado	280	8	904	2
Illinois	270	10	620	10
Michigan	280,310	8	900,960	3
Minnesota	300	5	720	8
Oregon	300	5	630	9
Washington	300	5	600	11
Wisconsin	236	11	826	4
Median Fees	300		723	

SOURCE: Provost's Office, University of Illinois: Cornell fees apply only to the state-related part of that university. The University of Michigan charges under-classmen lower fees than juniors and seniors.

As the operations at the four smaller state universities probably more closely resemble those of teacher colleges and other smaller state universities, a compilation of tuition and other required fees at some of these institutions was made. Again, it can be said that resident tuition and other required fees tend to be slightly lower in Illinois than in similar colleges in other states though non-resident fees were higher in Illinois. The fees in Table 21 are for the 1961-1962 academic year, and probably were somewhat increased in some institutions for the 1962-1963 year.

Should tuition and fees at Illinois state universities be increased? Many factors must be considered in answering this question. State universities were established to provide a higher education for those, who might otherwise be deprived of one. These universities, then, have long considered relatively low tuitions essential in performing their function of expanding the highly educated segment of our population. Increasing these fees, then, might jeopardize the existing philosophy behind public higher education. Depriving stu-

dents of a college education in these times of increasing complexity would be most unfortunate. As a prominent student of public finance has said:[11]

> Educational services in part directly benefit the individuals receiving them, and thus a limited amount can be produced and sold by private enterprise. But there are likewise substantial gains to society from the provision of at least a minimum level of education to all persons. Education allows greater skill and thus larger potential output and facilitates economic development. An educated citizenry is likely to provide a more discerning electorate and greater political stability. Although some persons will obtain an education or provide it for their children even if they must pay for it, those families whose incomes are relatively low or who have a low estimate of the benefits from education will not do so. Thus total educational services received will be less than the optimum unless they are provided free of charge.

Even with present tuition rates, the cost of sending a child to any one of the state universities now exceeds $1,500 annually, or $6,000 for four

TABLE 21

Tuition and Required Fees, Selected Smaller State Universities and Teachers Colleges, 1961-1962

School	Resident Fees	Non-Resident Fees
Ball State Teachers College	$225	$315
Bowling Green State University	400	750
Central Michigan University	215	445
Colorado State College	240	408
Eastern Michigan University	215	335
Mankato State College	198	294
N. E. Mo. Teachers College	105	180
San Jose State College	87	340
Wisconsin State College	205	340
MEDIAN FEES	215	340
MEDIAN, FOUR SMALLER ILLINOIS UNIVERSITIES	194	364

SOURCE: Bulletins and Catalogues of the various schools.

years. Even families with moderately high income find this a very considerable expense.[12] Furthermore, some families fail to save for their children's higher education because they do not realize the substantial material benefits gained from a college degree. Most people would agree that a child

[11] John F. Due, *Governmental Finance*, 1959, p. 14.

[12] Dr. William McLure, in another report in this report, suggests tuition fees should be lowered because, "Over half of the students in higher education have an economic struggle to stay in school."

should not be deprived of an educational opportunity because of the lack of foresight of his parents.

A strong case, though, can be made for some increase in fees at the six state universities. To begin with, tuition and related fees are at a relatively minor part of the total cost of going to college: room, board, and other expenses are significantly greater items. Boosting tuition fees 25 percent might mean only a 3 or 4 percent increase in the total cost of going away to college.

Then, too, the revenue from any increase in tuition could be partially allotted to increase student financial aid, eliminating financial hardships incurred by lower-income students. But, then, would a tuition increase be fair to students from upper-income homes? Even with a fairly large tuition increase, the state would still be substantially subsidizing the well-to-do student. Remember, much of the direct benefit of the education accrues to the individual rather than society, although important social benefits are involved. Where an individual receives extensive private benefits from a service provided by the State, he should be expected to pay for the benefits gained to the extent that he is capable.

To what extent an increase in fees would lead to students entering private or out-of-state colleges is impossible to ascertain accurately, although this is a factor to be considered in any fee revision.

With non-resident tuition fees an additional factor must be considered, namely, retaliatory action by other states. Illinois is a net exporter of students. Increasing non-resident tuition fees considerably could conceivably lead to retaliatory action by other states, resulting in fewer students leaving the state to study. Thus it is possible that a sizable increase in non-resident fees would lead to increased enrollments at Illinois universities from resident students, thereby adding to the State's financial burden. How real this retaliatory threat may be is difficult to gauge; nonetheless, restraint should be exercised in increasing non-resident fees.

Some schools charge higher tuition rates for students benefiting from especially high-cost instruction. Thus, some schools or colleges within a university may charge more than others. Occasionally, upperclassmen pay more than freshmen and sophomores because the cost of educating a junior or senior is typically higher. For example, the University of Michigan charges juniors and seniors $30 more than freshmen and sophomores, presumably reflecting the difference in instructional costs. This principle might be extended to graduate students who receive much individual attention from distinguished, more highly paid faculty members. Charging higher fees to more advanced students, though, has a serious drawback. The more advanced students are valuable assets to the universities and society as they teach and add to the sum of knowledge as well as learn. Furthermore, the older students more likely have families to support so increased fees could be a serious

hardship. Whether the advantages to variable tuition fees exceed the drawbacks is doubtful.

After considering all the factors, it appears some increase in tuition fees can be made without jeopardizing the philosophy of the state university system. Caution must be exercised, however, as any fee increase which would prevent large numbers of students from receiving a college education would be extremely unfortunate. It would appear advisable, therefore, to increase student scholarships and loans along with any tuition increase, so students with minimal financial support would not be deprived of an education.

Any estimate as to what extent tuition fees could be increased without having undesirable effects is conjectural. Thus it seems likely that increasing fees modestly would be the most prudent course. Table 22 shows a fee schedule which provides for fairly conservative increases in fees.

TABLE 22

Proposed Tuition Fees — Regular Academic Year

University	Resident Tutition Fee		Non-Resident Tuition Fee	
	Present	Proposed	Present	Proposed
Illinois	$170	$210	$520	$640
Southern Illinois	126	180	276	450
Eastern Illinois	120	150	290	375
Illinois State Normal	120	150	290	375
Northern Illinois	120	150	290	375
Western Illinois	120	150	290	375

Non-instructional fees, such as student union fees and dormitory charges, should generally cover the cost of the service provided, and should be changed accordingly. The author, however, is particularly concerned with the growing practice to increase these fees in order to construct desirable but nonessential buildings. A recently imposed $40 annual fee at the University of Illinois to help finance a union building addition, assembly hall, hospital addition, and a "student services" building is an example of this. If, as Dr. William P. McLure says,[13] "Over half of the students . . . have an economic struggle to stay in school," then further construction of elaborate non-instructional edifices financed by student fees is totally indefensible.

[13] In this report of the Illinois Commission on Revenue.

CHAPTER XXVI

POTENTIAL SOURCES OF ADDITIONAL STATE TAX REVENUES*

By H. K. Allen

Prominent among the potential sources of new state tax revenues for Illinois that warrant consideration are the individual and corporation income taxes. Brief reference was made to the former in the chapter on the General Property Tax and to the latter in the chapter on General Corporation Taxes. Estimates of additional revenues that could be obtained from changes in specific taxes are found in the chapters that deal with such taxes.

Individual Net Income Tax

As of September 1, 1960, the latest date for which detailed information is available, thirty-three of the fifty states levied some form of individual net income tax. Progressive rate schedules are employed in a large majority of the states, but the rates are low as compared with the Federal structure and the degree of progression is moderate. In most states, the schedules start with a rate of one or two percent in the first bracket and the maximum rate in any of the states was 11 percent in North Dakota. In Alaska the rate is 14 percent of the Federal tax payable upon net income derived from sources within Alaska. West Virginia adopted a federally-related tax in 1961, the rate of which is 6 percent of taxable income as computed under the Federal law. In New Hampshire and Tennessee, the income tax is applicable only to the income from intangibles.

Personal exemptions for a married person, head of a family, and a single person are higher in most states than they are under the Federal law and the average credit for each dependent is about the same as the comparable Federal credit. More than half of the states allow deduction of the Federal income tax in computing net taxable income, and in approximately one-half the states the tax on salaries and wages is required to be withheld at the source.

Total individual income tax revenues of all states which levied individual income taxes amounted to 19 percent of total state tax revenues in such states in 1960. In that year Oregon derived 45 percent of total state tax revenues from the indivdual income tax. Louisiana and Mississippi, on the other hand, obtained less than 3 percent from this source. Per capita revenues from this source in states which levy general income taxes ranged from $3.51 in Mississippi to $45.48 in Hawaii.

The major features of individual net income taxes in Alaska, California,

[1] Also, see Warren R. Harden and W. Douglas Poe, *Tax Alternatives for Illinois*, Illinois State Normal University, Normal, 1962.

TABLE 1

Major Features of Selected State Individual Net Income Taxes, 1960*

State	Lowest Bracket		Highest Bracket		Maximum Personal Exemption			Federal Income Tax Deduction	Revenue Fiscal 1960	
	Rate (Per-cent)	To Net Income of	Rate (Per-cent)	Income Above	Married or Head of Family	Single	Credit for Each Dependent†		Total (000) Omitted)	Per Capita
Alaska	‡	‡			$1,200	$ 600	$600	No	$ 8,903	$39.36
California§	1	$2,500	7	$15,000	3,000	1,500	600	No	245,797	15.64
Oregon§	3	500	9.5	8,000	1,200	600	600	Yes	94,641	53.51
New York	2¶	1,000	10.¶	15,000	1,200•	600•	600	No	756,364	45.07
Wisconsin	1**	1,000	8.5**	14,000	14††	7††	7††	Yes	139,324	35.26

SOURCE: Major features were derived from State Individual Net Income Tax Rates, *Facts and Figures on Government Finance*, Tax Foundation, Inc., 1961, p. 182. Statistics on revenues are from *State Government Finances in 1960*, U. S. Bureau of the Census, Tables 5 and 35.

*From laws in effect on September 1, 1960.

†A taxpayer with "head of family" status is generally disallowed deduction for one dependent.

‡Rate is a flat 14 percent of Federal tax payable upon net income derived from source within Alaska.

§Income-splitting is permitted in computation of tax on joint returns.

¶Capital gains taxed at one-half regular rates: effective January 1, 1961, taxed at regular rates; effective January 1, 1961, taxed at regular rates. Unincorporated businesses taxed at 4 percent.

•Tax credits of $25 for married couple and head of household and $10 for single taxpayer are in addition to exemptions shown.

**In addition, surtax of 20 percent levied on computed tax on 1960 income.

††Amount deductible from tax in lieu of exemption.

‡‡Limited to 3 percent of net income.

Oregon, New York, and Wisconsin are presented in Table 1. If the provisions of the laws of these states should be adopted in Illinois, it is estimated that the annual revenues, based on 1960 incomes, would be as follows:[2]

Alaska	$378,100,000
California	150,200,000
Oregon	599,800,000
New York	425,700,000
Wisconsin	426,500,000

It will be noted that the individual income tax systems of Alaska, Oregon, New York, and Wisconsin are lucrative sources of revenue. Because of somewhat lower rates and substantially higher personal exemption, adoption in Illinois of the California plan would produce considerably less revenue than would any of the other four plans. If Illinois should decide to enter the individual income tax field, the California plan, in the opinion of the writer, is much to be preferred over the others. One of the major purposes of levying a state individual income tax should be to reduce the regressivity of the over-all state and local tax system. Since California, like Illinois, relies rather heavily on sales and other gross receipts taxes, the California income tax does make a modest contribution in reducing regressivity. A married couple with two dependents in California have little, if any, income tax liability on an annual net income of $5,000. Families in the $5,000 and under income group, however, are hit fairly hard by the sales and other gross receipts taxes. On the other hand, the California plan requires families in the higher income groups to make a modest tax contribution in addition to the gross receipts taxes they pay. The latter category of taxes takes a smaller percentage of net income of families in the higher income groups than it does of families in the lower income groups. Hence it can be argued that the former should be required to pay a moderate income tax.

Alaska, Oregon, New York, and Wisconsin derive a smaller percentage of total state tax revenues from gross receipts taxes than is the case in California. Within limits, this fact would justify somewhat greater emphasis on the income tax in these states. The question may be asked, however, as to whether the combined federal and state income tax burden on families in the higher income groups in Alaska, Oregon, New York and Wisconsin is not unjustifiably burdensome. It is, of course, difficult if not impossible, to determine the extent to which tax burdens undermine incentives, but it is certain that a heavy tax burden does so to a greater extent than a light tax burden. Direct taxes such as income taxes appear to have a greater effect upon incentives than do indirect taxes. The weight of the argument appears to be definitely in favor of a moderate rate structure and high personal exemptions in a state individual income tax system.

[2]Differences in per capita personal income between Illinois and the other states were taken into account in making the estimates.

The California law does not permit the deduction of the Federal income tax in computing net taxable income for state purposes. If deductibility of the Federal tax were allowed, it would confer a special advantage on taxpayers in the higher income groups. Such an allowance, however, makes a state individual income tax more acceptable to taxpayers generally. If the California plan should be adopted in Illinois, it should, in the opinion of this writer, be modified to permit deductibility of the Federal tax. Such a change would reduce the estimated revenues that would be obtained in Illinois from $150,250,000 to about $115,000,000 annually.

In addition to the fact that a state individual income tax, if levied with fairly high personal exemptions, reduces the regressivity of the over-all state and local tax burden, this tax is the fairest of all taxes. Most taxes are ultimately paid from income and net income is the best of all criteria for measuring the productivity of assets and services, and the capacity of the recipient to pay taxes. An individual income tax in Illinois would be an especially appropriate medium for reaching the superior capacity to pay taxes possessed by recipients of lucrative incomes from professional services and fees. Such a tax, moreover, would be an effective and equitable means, if coupled with withholding of the tax at source, of reaching incomes from stocks, bonds, mortgages, and other intangibles which largely escape taxation under the present tax system.

Although of less significance in the case of an individual income tax than in that of a corporation income tax because of the higher federal rates for corporations, state income taxes are deductible in computing net taxable income under the federal income tax laws. This means that part of the burden of state income taxes is borne by the Federal Treasury. In fairness, it should be noted that most state taxes are deductible under the federal law.

One of the major disadvantages of adopting a state individual income tax in Illinois, is that new machinery would have to be established to administer the tax. An increase in the base and/or rate of the sales and use taxes on the other hand, would produce a substantial amount of additional revenue with a relatively small increase in administrative costs. The income tax, moreover, if accompanied by an adequate compliance program, has a relatively high cost for each dollar of revenue collected.

Another argument against adopting a state individual income tax in Illinois is that even if the initial rates were low and personal exemptions high, the urgent need for additional revenues in later years might result in increases in rates and reductions in personal exemptions to the point where the burden might seriously undermine incentives and retard economic growth. Such an eventuality might, of course, be forestalled by specifying the rates and personal exemptions in the Constitution. Some people would argue that the high rates of the federal individual income tax have given the Federal Government a monopoly of this field and that a state tax imposed on top of the federal tax would produce an intolerable burden.

Because of the extraordinary complexity of income tax laws, consideration should be given to relating the state law to the federal law if the General Assembly of Illinois should desire to levy a state individual income tax law. As previously mentioned the income tax laws of Alaska and West Virginia are so related. With some differences in details, the individual income tax laws of both of these states are based on federal income tax liability. Since the federal income tax is progressive, this type of state income tax would also be progressive. The federal individual income tax liability after credits in Illinois in 1959, the latest year for which data are available, was $2,866,575,000.[3] A state tax in Illinois, based on federal income tax liability, would produce approximately $28,600,000 for each one percent of rate.

Another possible type of federally-related income tax would be to use taxable income as computed under the federal law and apply the desired state rate. Taxable income under the federal law is defined as adjusted gross income less deductions and dependency allowances. Taxable income of Illinois taxpayers in 1959 amounted to $12,449,922,000. Hence, an Illinois tax of this type would produce approximately $125,000,000 annually for each one percent of rate. Statistics are not available to permit estimated revenues under a progressive rate structure.

One objection to either of the two types of federally-related taxes mentioned above is that the state tax liability determined thereby reflects the current level of personal exemptions in the federal law which in the opinion of the writer are lower than they should be in an individual income tax system suitable for Illinois. This objection could be overcome by authorizing deduction in the state law of appropriate personal exemptions from the selected federal base.

A third possible type of federally-related personal income tax would be to employ adjusted gross income as computed under the federal statute as the base. Such a tax would be less regressive than a retail sales tax. but it would not make any allowance for the number of dependents nor for contributions to tax-exempt organizations and other deductions permitted under the federal law. It would obviously be a broadly-based tax and would produce a great deal of revenue with a low rate.[4] Adjusted gross income of Illinois taxpayers amounted to $20,932,430,000 in 1959. Such a tax in Illinois would produce approximately $210,000,000 of each one percent of rate.

The chief advantage of the federally-related state income taxes is that they greatly simplify administration. It can be provided in the law that a copy of the federal income tax report must be sent to the appropriate agency. The official state report could be brief and simple. A further important ad-

[3] U. S. Treasury Department, Internal Revenue Service, *Statistics of Income . . .1959, Individual Income Tax Returns*, Table 16, p. 67.

[4] For a more detailed discussion of various types of federally-related taxes, see E. B. Schmidt, *Designing A Federal-Related Income Tax for Nebraska*, University of Nebraska Agricultural Experiment Station, Lincoln, 1962.

vantage is that copies of audits of federal income tax returns could be made available to state income tax authorities, thereby greatly facilitating compliance.

The chapter on constitutional problems contains a discussion of the constitutionality of an individual income tax in Illinois.

Corporation Net Income Tax

Careful consideration should be given to adopting a corporation net income tax in Illinois. As of September 1, 1960, the latest date for which information is readily accessible, thirty-six states levied a corporation net income tax. Seven states employ a progressive rate structure, the lowest bracket rate of which is 1 percent in Arizona and Arkansas; the highest bracket rate is 7 percent in Kentucky and Wisconsin. Of the twenty-nine states, excluding Alaska, which employ flat rates, the distribution relative to rates is as follows:

Rate	Number of States	Rate	Number of States
1.75	1	5.00	7
2.00	2	5.50	2
3.00	2	6.00	4
3.50	1	6.765	1
3.75	2	9.30	1
4.00	4	9.50	1

The rate in Alaska is 18 percent of the federal tax payable upon net income derived from sources in Alaska. It will be noted that the rates most frequently levied are 4, 5 or 6 percent. The federal corporation income tax is deductible in computing the tax base in about one-half the states, although the deduction is limited to 10 percent of net income in Wisconsin. In the thirty-six states which levied corporation net income taxes in 1960, total collections from this source amounted to 9.4 percent of total state tax revenues in such states. In Pennsylvania, 13.8 percent of total state tax revenues came from this source. On the other hand, only 3.2 percent of total state tax collections was obtained from this source in Missouri.

In the chapter on General Corporation Taxes, Ruth Birdzell estimates that adoption in Illinois of a corporation net income tax similar to that of California (5.5 percent rate) would produce about $144 million annually (based on 1960 corporation income) or about $26 million dollars for each one percent of rate. Because of the fact that state corporation income taxes are deductible in computing the federal tax, the imposition of such a tax in Illinois would result in an increase in the combined federal-state tax liability by an amount substantially less than the Illinois tax. In other words, the

imposition of the tax would result in the transfer of a substantial sum of money from the federal treasury to the state treasury. This is true because of the high rates of the federal tax, especially on the larger companies, the bulk of whose income is subject to the 52 percent federal rate.

The strongest argument against the adoption of a corporation income tax in Illinois is that corporations already bear an unconscionably high tax burden under the federal corporation income tax. It is possible that a small reduction will be made in the federal tax rates in the near future, but it is unlikely that substantial relief will be provided. Corporations also pay large amounts of local property taxes in Illinois. Although of less significance than in the case of an individual income tax, adoption of a state corporation tax would require a new agency to administer the tax and would result in an increase in collection costs. This problem could be greatly minimized, however, by relating the state tax to net taxable income under the federal law and by requiring that a duplicate copy of the federal report be sent to the state.

Finally, it can be argued that Illinois should not adopt a corporation income tax because it would make the state less favorable in attracting new industries. Proponents of this argument assert that the "tax image" of Illinois is favorable and that it should be kept that way.

The strength of the case for adoption of a corporation net income tax in Illinois depends somewhat on what disposition is made of the capital stock tax and the bank share tax and whether the base and/or rate of the state franchise tax on corporations is increased. The gross defects in the capital stock tax were thoroughly discussed in the chapter on General Corporation Taxes. Since it is unlikely that the administration of the capital stock tax will be markedly improved, the preferred course of action is to repeal the tax and exempt intangibles owned by corporations from the property tax. If the capital tax should be repealed, a corporation tax on net income would be by far the best replacement. Income is a better criterion of capacity to pay taxes than the value of intangibles. The percentage of the capital stock tax to net income varies widely among corporations. Relative to net income, this tax is a highly capricious and discriminatory type of tax.

Another advantage of a corporation net income tax over the capital stock tax is that it would apply to the income of foreign corporations which originates in Illinois. The capital stock tax applies only to domestic corporations. Many Illinois corporations are now paying state corporation income taxes to states in which part of their income originates, but Illinois has no means of according similar treatment to foreign corporations who derive income from Illinois.

Finally, the adoption of a net corporation income tax and the repeal of the capital stock tax would terminate the revenue windfalls which a few communities in Illinois derive from the latter. Revenues from the former would go into the state treasury where they could be used for the benefit

of all the citizens of the state, or part of them could be allocated back to local units on a state-wide basis.

The bank share tax, a feature of the property tax, places an unfair burden upon bank shareholders as compared with owners of other types of intangibles. Although the assessments are not made in a uniform manner, few shares of bank stock escape taxation in Illinois. On the other hand, few intangibles of other types are assessed. In relation to net income, the bank share tax, like the capital stock tax, is grossly inequitable. A strong case can thus be made for repeal of the bank share tax and the levy of a net income tax at the same rate selected for the taxation of other corporations.

Several attempts have been made in recent years to increase the rate of the state franchise tax on corporations (present rate is 1/20 of one percent) and consideration has been given to including earned surplus in the base in addition to stated capital and paid-in surplus. Here again, wide differences exist among corporations in the relationship between stated capital, paid-in surplus, and earned surplus on the one hand and net income on the other. The levy of a tax on corporation net income would be a much more equitable method of raising additional revenues than increasing the rate of the franchise tax and/or broadening the base to include earned surplus.

It is true that the state tax situation in Illinois is favorable for the location of new industries and for the retention of existing ones. No prudent person would propose that any changes should be made in the tax structure which would reverse this situation. It is the opinion of the writer that the levy of a 3 or 4 percent tax on corporation net income would not adversely affect economic growth or the location and retention of industry in Illinois. There are few, if any other states, in which businesses would desire to locate, that have lower rates than those proposed for Illinois.

If the General Assembly in Illinois should levy a corporation net income tax, the rate should be moderate. In order to assure that the rate would not be increased to an inordinate level at some future date, the maximum limit of such a rate could be prescribed in the Constitution.

The rate should be a flat rate rather than progressive. The effect of a progressive rate upon the stockholders of a corporation is that of a proportional rate. The effective proportional rate varies from corporation to corporation and is thus inequitable. A progressive rate structure makes no allowance, moreover, for rate of return on invested capital. A large company may have a low rate of return on invested capital, but pay a large tax because it has a large amount of net income in dollars. A small corporation, on the other hand, may have a high rate of return on invested capital but may pay a smaller tax because a larger proportion of its income falls in the lower brackets. These difficulties can be avoided through the levy of a flat rate tax which takes a proportional amount of the net income of all corporations.

If it should be desired to replace the capital stock tax and the bank

share tax with a corporation net income tax, part of the revenues could be shared with local governments. It is estimated that the capital stock tax is currently producing about $24,000,000 annually and that about $7,000,000 is being obtained each year from the bank share tax. These revenues go to the local governmental units. In the case of the capital stock tax, to the local units in which the "principal office" of the corporation is located; and in the case of banks, to the units in which the bank is located. The levy of a corporation income tax with a rate of 1¼ percent would produce an amount of revenue equal to present revenue from the capital stock and bank share taxes combined. As an alternative to increasing the rate and/or base of the franchise tax, and to provide other additional revenues that might be needed, a rate of up to 3 or 4 percent could be defended.

Corporation Franchise Tax

The annual corporation franchise tax in Illinois is based on stated capital and paid-in surplus represented in Illinois, and the current rate is one-twentieth of one percent. The yields of this tax for the fiscal year which ended June 30, 1961, was $6,871,785. Practically all states levy a franchise tax measured by capital stock and surplus. Franchise taxes of this type are to be distinguished from the franchise taxes measured by net income which are levied in many states.

The rate of the Illinois franchise tax is one of the lowest of any of the states, but only Michigan, New Jersey, Ohio, Pennsylvania, and Texas obtain a substantial amount of revenue from franchise taxes based on capital stock and surplus. The underlying theory of this tax as it has been employed in Illinois and most other states is that it is in reality a kind of license fee, the rate of which should not be higher than is needed to produce sufficient revenue to cover the cost of issuing corporation charters and performing other services related to the regulation of corporations.

As mentioned above, several attempts have been made to increase the rate of Illinois franchise tax in recent years. For each increase of one-twentieth of one percent of rate, revenues would rise about $7,000,000 annually. The inclusion of earned surplus, as some persons have advocated, would approximately double the base and would thus double annual revenues.

Advocates of increasing the rate and/or base of the Illinois franchise tax argue that corporations in general bear a light burden of state taxes in Illinois. The burden of state taxes on corporations in Illinois is light as compared with most other states, but it does not follow that an increase in the franchise tax is a desirable method of increasing the burden. As previously suggested, a corporation net income tax would be the most equitable form of tax that could be employed for raising any additional revenues that might be desired from corporations in Illinois. Net income of corporations varies widely relative to stated capital, paid-in surplus, and earned surplus.

A tax based on capital and surplus thus takes widely varying percentages of net incomes of various corporations. Some small corporations and perhaps some large ones might be severely hurt by a substantial increase in the franchise tax.

If it should be decided to increase the rate of the franchise tax rather than to levy a corporation net income tax, earned surplus should be included in the base. Earned surplus is a profit-related factor and if the franchise tax is to be converted into a revenue measure it should be included in the base.

Net Income Tax on Salaries, Wages and Individual Business Net Profits

In 1959, the latest year for which statistics of income, compiled by the Internal Revenue Service from individual income tax returns, are available, the following amounts of income were received by Illinois taxpayers:

SOURCE	AMOUNT
Wages and Salaries	$17,263,484,000
Business Net Profit	1,995,174,000
	$19,258,658,000

Because of the large base, a tax of one percent on income from wages, salaries and individual (including partnership) business profit reported to the Internal Revenue Service would produce (based on 1959 statistics) $192,586,580 annually. The items included in the base are components of adjusted gross income and therefore do not reflect any allowance for personal exemptions. One of the advantages of such a tax would be that it would reach lucrative incomes from professional services which are not adequately taxed under the present state tax system. The levy of a tax on business net income could be justified, moreover, if a state net income tax were levied on corporations. New York levies a 4 percent tax on the net income of unincorporated businesses. For families in the low income group, such a tax would be much less burdensome than an increase in the rate of the sales tax. This tax would also be seriously defective in that it does not include income from dividends, interest, rents, and royalties which accrue largely to wealthy individuals. Such incomes would, of course, be included in a general state individual income tax.

Income Tax on Dividends and Interest

New Hampshire levies a special tax applicable to interest and dividend income only. The rate of the tax is 4.25 percent, and an exemption of $600 is allowed for a married person, head of a family, and a single person. The tax is not withheld at the source. Revenue from this tax in 1961 was $1,631,000. Tennessee levies a similar tax on stock dividend and bond in-

terest income when over $25, except 4 percent on income from stock of any corporation, 75 percent of whose property is taxable in Tennessee. The rate of the tax, except as noted, is 6 percent. No personal exemptions are allowed and the tax is not withheld at the source. This tax yielded $5,984,000 in 1961.

If the New Hampshire plan should be adopted in Illinois, it is estimated, with allowance for the difference in personal income between the two states, that it would produce about $34,000,000 annually. The estimated yield from adoption of the Tennessee plan in Illinois is $26,400,000. These estimates are probably conservative because per capita personal income is substantially higher in Illinois than it is in New Hampshire and Tennessee. It appears likely, therefore, that the estimate is on the low side. Withholding of the tax at the source would undoubtedly increase collections, but it is fraught with complex administrative problems.

Another approach would be to base the tax on dividends and interest reported by Illinois residents under the federal income tax law. The amounts reported in 1959 were $579,758,000 from dividends and $244,741,000 from interest, or $824,499,000 from the two sources combined. Using amounts reported in 1959, it is estimated that an income tax on interest and dividends would produce about $8,240,000 in revenue annually for each one percent of rate.

If a special state income tax should be levied on income and dividends, it would be expected that intangibles would be exempted from the general property tax. It will be remembered that the taxation of intangibles under the general property tax is a dismal failure in Illinois. It is estimated that the amount of revenue that the local governmental units would lose from the exemption of intangibles, including bank shares, owned by Illinois residents would be about $11,000,000 annually. Bank shares alone account for more than half of the estimated loss.

Adoption of a special income tax as a substitute for the general property tax on intangibles would be a marked improvement, but such a limited income tax, in the opinion of the writer, is inferior to a general individual income tax. Exemption of intangibles from the general property tax would probably require a constitutional amendment.

Mortgage Recording Tax

Of the several states which levy a mortgage recording tax, that of New York is the most productive. The rate of the New York tax is 50 cents per $100 or major fraction thereof of principal indebtedness secured. The yield of the New York tax for the fiscal year which ended March 31, 1962, was $22,807,075.89. It is estimated that adoption of the New York plan in Illinois would produce about $13,000,000 annually. Except for the fact that this tax produces revenue, it has little to commend it. In the case of mortgages upon homes, it is regressive, that is, relative to income, it falls more

heavily upon low income families than upon high income families. It is discriminatory, moreover, as between short-term and long-term mortgages.

Tax on Non-Cigarette Tobacco Products

In the chapter on Tobacco, Alcoholic Beverages, and Pari-Mutuel Taxes, Karl Marx recommended adoption in Illinois of a tax on such non-cigarette tobacco products as cigars, smoking tobacco, chewing tobacco and snuff. He estimated that the minimum revenue from these sources would be from $5 million to $8 million annually. The rate on cigars proposed by Marx is from $2.00 per thousand on small cigars weighing not more than three pounds per thousand to $3.00 per thousand on all cigars weighing more than three pounds per thousand and retailing for twenty cents or more per cigar. Smoking tobacco, chewing tobacco and snuff, he proposes, should be taxed at a rate of 20 percent of the regular factory list price.

The Illinois Department of Finance estimates (based on 1960 sales) that approximately $3.5 million could be obtained from a tax of one cent per cigar with a 5 percent discount to the taxpayer. Expansion of the coverage of taxes on tobacco products would encounter difficult compliance problems but these problems are not insurmountable.

Classified Property Tax on Intangibles

As explained by the writer in the chapter on the General Property Tax, one possible way to improve the deplorable situation that exists relative to the assessment of stocks, bonds, mortgages, and other intangibles owned by individuals, would be to apply a low special property tax rate uniformly to all such intangibles throughout the entire state. Such a plan is employed in Ohio. The rate in Ohio is 5 percent of income yield on productive investments; 2 mills on unproductive investments; and 2 mills on bank deposits, shares in banks, building loan associations, and credit unions.

Based on 1960 statistics, it is estimated that adoption of the Ohio plan in Illinois would yield about $75 million annually, or approximately twice the amount derived from intangibles in Illinois under the general property tax in 1960. The reason that the increase in revenue is not greater is that bank shares are rather completely assessed in Illinois at present.

Suggestions for the administration of a classified property tax on intangibles, based on the Ohio plan, and devices that should be used in the assessment of intangibles are presented in the chapter on the General Property Tax.

The adoption of such a tax, if effectively administered, would be a marked improvement over the present system, but in the opinion of the writer it is not as desirable as a general individual income tax.

Severance Taxes

Many of the states which produce large quantities of coal, oil, iron ore, natural gas, timber, or other natural resources impose special taxes on the

extraction of such commodities. The taxes are either ad valorem or specific, or a combination of the two.

The production of coal and crude petroleum in Illinois amounted to 45,977,000 tons and 79,387,000 barrels, respectively in 1961. Based on 1961 production, a severance tax of 5 cents per ton on coal and the same rate per barrel on oil would produce about $6,268,000 annually in revenue.

Ease of administration is the chief advantage of severance taxes. The prinicipal disadvantage is that the volume of production of extractive industries varies widely relative to net income. A severance tax, especially if levied at too high a rate, might place Illinois companies at a competitive disadvantage with concerns in other states.

Tax on Stock Transfers and Commodity Futures

The number of shares of stock transferred on the Midwest Stock Exchange (located in Chicago) in 1961 was 43,791,000. It is estimated that a transfer tax of 4 cents per share would yield about $1,750,000 annually. The low yield of such a tax would place it in the category of "nuisance taxes."

The number of bushels of grain traded in the commodity futures markets (the Chicago Board of Trade and the Chicago Open Board of Trade) in 1961 was as follows:

Wheat	2,065,870,000	bushels
Corn	2,126,000,000	
Oats	840,000,000	
Rye	462,000,000	
Soybeans	12,593,000,000	
Total	18,086,870,000	bushels

On the basis of the volume of trading in 1961, it is estimated that a tax of 1/20 of one cent per bushel would produce about $9,000,000 annually.

In the case of both a tax on stock transfers and commodity futures, the tax would be collected from the exchanges and would therefore have a low cost of collection. The exchanges, however, could not absorb such taxes and would have to pass them on to the traders, thereby incurring substantial compliance costs. Even more important is the fact that the value of such markets to cash traders depends upon the unhampered participation of speculators, many of whom operate with a very small margin of profit. Even the low taxes used in computing the estimates might have a seriously adverse effect upon the markets.

Report of the Commission on Revenue

INDEX

INDEX